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Supreme Court, U.S.
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No. 10-915

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In the

Supreme Court of the United States

CITY OF CLEVELAND,
Petitioner,

v.

AMERIQUEST MORTGAGE SECURITIES, INC., ET AL.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Under *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938), to what extent can a federal court sitting in diversity predict governing state law on the basis of federal precedent that construes federal law?

PARTIES TO THE PROCEEDING

The City of Cleveland, Ohio is the Petitioner in these proceedings. The Respondents include the following:

Ameriquest Mortgage Securities, Inc.
Bank of America, N.A.
Citibank, N.A.
Citigroup Global Markets, Inc.
Countrywide Securities Corporation
Credit Suisse First Boston LLC
Credit Suisse (USA), Inc.
Deutsche Bank Securities, Inc.
Goldman Sachs & Co.
Greenwich Capital Markets, Inc.
HSBC Securities (USA), Inc.
JP Morgan Acquisition Corp.
Chase Bank U.S.A., N.A.
Merrill Lynch, Pierce, Fenner & Smith Incorporated
Morgan Stanley & Co., Inc.
Novastar Mortgage, Inc.
Option One Mortgage Corporation
Washington Mutual Bank
Wells Fargo Bank, N.A.
Wells Fargo Asset Securities Corporation

TABLE OF CONTENTS

QUESTION PRESENTED i

PARTIES TO THE PROCEEDING ii

TABLE OF AUTHORITIES vi

PETITION FOR A WRIT OF CERTIORARI 1

OPINIONS BELOW 1

JURISDICTION 1

STATUTORY PROVISIONS AND RULES INVOLVED 1

STATEMENT OF THE CASE 1

I. Introduction 1

II. Procedural History 3

III. The Claim for Public Nuisance 4

IV. Ohio Law of Proximate Causation 5

V. The Court of Appeals' Decision 6

REASONS FOR GRANTING THE WRIT 9

I. The Court has never precisely identified the means by which federal courts should resolve unsettled issues of state law. 9

II. The prediction of state law in diversity cases implicates fundamental tenets of federalism. 10

III. Federal courts effectively reinstate the practice banned in *Erie* when they make a state-law prediction based on federal decisions interpreting federal law. 13

IV. The Court should hold that federal courts may not predict state law in diversity cases on the basis of federal precedent interpreting federal law, absent an explicit directive from the state's highest court to proceed in this fashion. 14

CONCLUSION 16

APPENDIX

Appendix A: Opinion, United States Court of Appeals for the Sixth Circuit, (July 27, 2010) 1a

Appendix B: Memorandum Opinion and Order, United States District Court Northern District of Ohio Eastern Division, (May 15, 2009) 24a

Appendix C: Order, United States Court of Appeals for the Sixth Circuit, (October 14, 2010) 73a

Appendix D: Fed. R. Civ. P. 12 . . . . 75a

Appendix E: Second Amended Complaint (Jury Demand Endorsed Hereon), United States District Court Northern District of Ohio Eastern Division, (October 8, 2008) 80a

TABLE OF AUTHORITIES

CASES

Allstate Ins. Co. v. Menards, Inc.,
285 F.3d 630 (7th Cir. 2002) 9, 12, 15

Anza v. Ideal Steel Sup. Corp.,
547 U.S. 451 (2006) 8

Boyle v. United Tech. Corp.,
487 U.S. 500 (1988) 14

Bernhardt v. Polygraphic Co.,
350 U.S. 198 (1956) 15

Calbillo v. Cavender Oldsmobile,
288 F.3d 721 (5th Cir. 2002) 11

Canal Ins. Co. v. Underwriters at Lloyd's London,
435 F.3d 431 (7th Cir. 2006) 14

Canyon Cty. v. Syngenta Seeds, Inc.,
519 F.3d 969 (9th Cir.), *cert. denied*, 129 S.Ct.
458 (2008) 8

Chaney v. Dreyfus Serv. Corp.,
595 F.3d 219 (5th Cir. 2010) 10

Chase Manhattan Bank v. T&N plc,
905 F. Supp. 114 (S.D.N.Y. 1995) 14

City of Cincinnati v. Beretta USA Corp.,
95 Ohio St. 3d 416,
768 N.E.2d 1136 (2002) 7, 8, 9

Clinger v. Duncan,
166 Ohio St. 216, 141 N.E.2d 156 (1957) 5

CSX Trans. v. Trism Specialized Carriers,
182 F.3d 788 (11th Cir. 1999) 10

Curtis Lumber Co. v. Louisiana Pac. Corp.,
618 F.3d 762 (8th Cir. 2010) 10, 14

Di Gildo v. Caponi,
18 Ohio St. 2d 125, 247 N.E.2d 732 (1969) . . 6, 8

Ellis v. Grant Thornton LLP,
530 F.3d 280 (4th Cir.), *cert. denied*, 129 S.Ct. 652 (2008) 10

Erie R. Co. v. Tompkins,
304 U.S. 64 (1938) . . . . *passim*

Giles v. General Mot. Acceptance Corp.,
494 F.3d 865 (9th Cir. 2007) 10

Hanna v. Plumer,
380 U.S. 460 (1965) 9

Holmes v. SIPC,
503 U.S. 258 (1992) 7, 8

Janney Montgomery Scott LLC v. Tobin,
571 F.3d 162 (1st Cir. 2009) 10, 14

Lexington Ins. Co. v. Rugg & Knopp, Inc.,
165 F.3d 1087 (7th Cir. 1999) 11

Mazur v. Young,
507 F.3d 1013 (6th Cir. 2007) 10

Michaels v. State of New Jersey,
150 F.3d 257 (3d Cir. 1998) 12

Moore v. Sims,
442 U.S. 415 (1979). 12

Mudrich v. Standard Oil Co.,
153 Ohio St. 31, 90 N.E.2d 859 (1950) 5

Murphy v. Carrolton Mftg. Co.,
61 Ohio St. 3d 585, 575 N.E.2d 828 (1991) . . 6, 8

Official Committee of Unsecured Cred. v. R.F. Lafferty & Co.,
267 F.3d 340 (3d Cir. 2001) 10

Orion Fin. Corp. v. American Foods Group,
281 F.3d 733 (8th Cir. 2002) 11

Perry v. American Tobacco Co.,
324 F.3d 845 (6th Cir. 2003) 6

Phoung Luc v. Wyndham Mgmt. Corp.,
496 F.3d 85 (1st Cir. 2007) 11

Queen City Terminals v. General Am. Transp.,
73 Ohio St. 3d 609, 653 N.E.2d 661 (1995) . . 5, 6

Runner v. NYSE,
568 F.3d 383 (2d Cir. 2009) 10

Salve Regina College v. Russell,
499 U.S. 225 (1991) 9

Strother v. Hutchinson,
67 Ohio St. 2d 282, 423 N.E.2d 467 (1981) 5

Taylor v. Webster,
12 Ohio St. 2d 53, 231 N.E.2d 870 (1967) . . . 6, 8

Time Warner Enter.-Advance/Newhouse Partnership v. Barteret-Craven Elec. Membership Corp.,
506 F.3d 304 (4th Cir. 2007) 11

Todd v. Societe Bic, S.A.,
21 F.3d 1402 (7th Cir.), *cert. denied*, 513 U.S. 947 (1994) 12, 13

Wayne Moving & Storage v. School Dist.,
625 F.3d 148 (3d Cir. 2010) 13

West v. American Tel. & Tel.,
311 U.S. 223 (1940) 11

Williams v. United Parcel Serv.,
527 F.3d 1135 (10th Cir. 2008) 10

RULES

Fed. R. Civ. P. 12 . . . . 1, 3

OTHER AUTHORITIES

RAYMOND H. BRESCIA, "TAINTED LOANS: THE VALUE OF A MASS TORTS APPROACH IN SUBPRIME MTG. LITIG.," 78 *U. CIN. L. REV.* 1 (2009) 13

BRADFORD R. CLARK, "ASCERTAINING THE LAWS OF THE SEVERAL STATES: POSITIVISM AND JUDICIAL

Federalism after Erie," 145 *U. Pa. L. Rev.* 1459 (1997) 12, 14

"Cleveland Sues Big Banks over Subprime Fallout," *National Public Radio* (Jan. 11, 2008) 2

Cleveland versus Wall Street (Saga Prod. 2010) 3

Kyle Cutts, "City on the Brink: The City of Cleveland Sues Wall Street for Public Nuisance," 58 *Case W. Res. L. Rev.* 1399 (2008) 2

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Dolores K. Sloviter, "A Federal Judge Views Diversity Jurisdiction through the Lens of Federalism," 78 *Va. L. Rev.* 1671 (1992) . . . . *passim*

PETITION FOR A WRIT OF CERTIORARI

The City of Cleveland respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit.

OPINIONS BELOW

The Sixth Circuit's decision is reported at 615 F.3d 496 and appears in the Appendix at 1a-23a. The decision of the United States District Court for the Northern District of Ohio is reported at 621 F. Supp. 2d 513 and appears in the Appendix at 24a-72a.

JURISDICTION

The Sixth Circuit issued its judgment on July 27, 2010. On October 14, 2010, the court denied the City of Cleveland's petition for rehearing and rehearing en banc. Pet. App. 26a. Cleveland invokes this Court's jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS AND RULES INVOLVED

This petition involves Federal Rule of Civil Procedure 12(b)(6). Pet. App. 75a.

STATEMENT OF THE CASE

I. Introduction

This petition concerns federal courts' latitude to predict state law on unsettled questions for purposes of deciding diversity cases. More specifically, it addresses the constitutionality of formulating state-law rules in such actions based upon federal case law interpreting federal law.

The court of appeals in this case took this exact course. In doing so, it terminated a claim by the City of Cleveland that sought to apply common-law public nuisance doctrine to the recent financial meltdown and foreclosure crisis. Cleveland sued 21 investment banks that had financed subprime mortgages in the City, claiming that the defendants knew or should have known that their activity would subject Cleveland to an epidemic of foreclosures and other attendant injuries.

With its lawsuit, Cleveland is attempting to extend settled state law to a new context, created by contemporary circumstances. The case has received extensive coverage from the national news media,[1] generated considerable legal commentary,[2] and inspired a documentary that debuted at the Cannes International Film Festival.[3] The court of appeals, however, preempted the action, affirming dismissal almost solely in reliance upon federal case law.

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[1] CHRISTOPHER MAAG, "CLEVELAND SUES 21 LENDERS OVER SUBPRIME MORTGAGES," *NEW YORK TIMES* (Jan. 11, 2008); "CLEVELAND SUES BIG BANKS OVER SUBPRIME FALLOUT," *NATIONAL PUBLIC RADIO* (Jan. 11, 2008); MICHAEL HIRSH, "MORTGAGES AND MADNESS," *NEWSWEEK* (MAY 24, 2008); RICK KARR, "MORTGAGE MELTDOWN," *BILL MOYERS JOURNAL* (JULY 18, 2008); MARK WINSTON GRIFFITH, "THE BEST OF 2008: GOING AFTER THE PREDATORY LENDERS," *www.huffingtonpost.com* (Dec. 12. 2008); DAVID ELLIS, "WALL STREET 1, CLEVELAND 0: CITY CAN'T SUE BANKS FOR BAD LOANS," *CNNMONEY.COM* (July 28, 2010).

[2] *See, e.g.*, CREOLA JOHNSON, "FIGHT BLIGHT: CITIES SUE TO HOLD LENDERS RESPONSIBLE FOR THE RISE IN FORECLOSURES AND ABANDONED PROPERTIES," 2008 *UTAH L. REV.* 1169 (2008); KYLE CUTTS, "CITY ON THE BRINK: THE CITY OF CLEVELAND SUES WALL STREET FOR PUBLIC NUISANCE," 58 *CASE W. RES. L. REV.* 1399 (2008); MELISSA C. KING, "RECOUPING COSTS FOR REPAIRING

II. Procedural History

Cleveland filed this lawsuit on January 10, 2008 in Ohio state court. The 21 defendants removed it to the United States District Court for the Northern District of Ohio on the basis of diversity of citizenship. Cleveland's Complaint contained one count for public nuisance. The City retained this single claim in its Second Amended Complaint, which both added and eliminated certain defendants. Pet. App. 80a-102a.

On May 15, 2009, the District Court dismissed this lawsuit in its entirety under Rule 12(b)(6) of the Federal Rules of Civil Procedure. Pet. App. 24a-72a. The court of appeals affirmed on July 27, 2010, based exclusively upon Cleveland's purported failure to plead proximate causation. Pet. App. 1a-23a. On October 14, 2010, the court of appeals denied the City's motion for rehearing en banc. Pet. App. 73a-74a.

BROKEN WINDOWS: THE USE OF PUBLIC NUISANCE BY CITIES TO HOLD BANKS LIABLE FOR THE COSTS OF MASS FORECLOSURES," 45 *TORT & INS. L. J.* 97 (2009); S. ADELINE MCKINNEY, "MUNICIPALITIES FIGHT EFFECTS OF FORECLOSURE WITH LITIGATION AND NEIGHBORHOOD STABILIZATION PROGRAM GRANTS," 14 *N.C. BANKING INST.* 257 (2010); MATTHEW SAUNIG, "REBRANDING PUBLIC NUISANCE: *CITY OF CLEVELAND V. AMERIQUEST MTG. SEC., INC.* AS A FAILED RESPONSE TO ECONOMIC CRISIS," 59 *CATHOLIC U. L. REV.* 911 (2010).

[3] *Cleveland vs. Wall Street* (Saga Prod. 2010).

III. The Claim for Public Nuisance

Between 2002 and 2007, the annual number of foreclosures consummated in Cleveland increased from a few hundred to more than 7,500. SECOND AMENDED COMPLAINT ("SAC"), ¶12. An average of 20 Cleveland homeowners faced foreclosure each day during 2007. *Id.*, ¶61. This surge was a distinctly subprime phenomenon. Over the three-year period ending in early 2008, more than 80 percent of all foreclosures in Cleveland involved subprime mortgages. The subprime foreclosure rate exceeded the rate on conventional loans by more than 800 percent. At the time this lawsuit began in 2008, a full third of the subprime loans made in Cleveland during 2005 had already ended in default and foreclosure. *Id.*, ¶13.

Each and every foreclosure that took place in Cleveland created certain tangible costs for the City. These included increased expenditure for fire and police protection, maintenance costs, and the cost of demolition. In any individual case, Cleveland's expenses can range well into the five figures. SAC, ¶64. Foreclosures also ravaged Cleveland's property-tax revenues, the amount of which turns upon the appraised value of real estate in the City. *Id.*, ¶65-¶66. All told, the City's losses range well into the millions.

The defendants each financed subprime mortgages in Cleveland through the process of securitization. SAC, ¶15-¶34. In this lawsuit, the City has alleged that these parties knew or should have known that this activity would cause a tidal wave of foreclosures, bringing with it all of the attendant damage sustained by Cleveland. *Id.*, ¶53, ¶67, ¶69. Cleveland's unique economic plight made this so. While the rest of the country experienced a housing bubble, home values stagnated in the City, which ranked among the nation's poorest. Median income rates faltered during the heyday of subprime, as did Cleveland's overall economy. *Id.*, ¶53-¶55.

The City simply lacked the wherewithal to absorb the massive influx of subprime financing engineered by the defendants. The foreclosure crisis represented the foreseeable and inevitable result of their securitization activity. Cleveland based its public nuisance claim upon these allegations.

IV. Ohio Law of Proximate Causation

Ohio has well-developed and longstanding jurisprudence on proximate causation, which it generally treats as an issue of fact. *Strother v. Hutchinson*, 67 Ohio St. 2d 282, 288, 423 N.E.2d 467 (1981). This element of tort law entails "some reasonable connection between the act or omission of the defendants and the damage the plaintiff has suffered." *Queen City Terminals v. General Am. Transp.*, 73 Ohio St. 3d 609, 618, 653 N.E.2d 661 (1995) (quotation marks omitted).

More specifically, proximate cause exists where the plaintiff's injury "would not have taken place" but for the "natural and continuous" chain of events triggered by the defendants' misconduct. *Clinger v. Duncan*, 166 Ohio St. 216, 222, 141 N.E.2d 156 (1957). The defendants also must have reasonably foreseen the harm resulting from their actions. *Mudrich v. Standard Oil Co.*, 153 Ohio St. 31, 39, 90 N.E.2d 859 (1950). With respect to this last requirement, if an "event causing injury appears to have been closely related to the damage created by the original conduct, it is regarded as within the scope of the risk, even though ... the particular injury would not have been" reasonably expected. *Di Gildo v. Caponi*, 18 Ohio St. 2d 125, 130, 247 N.E.2d 732 (1969).

An independent "intervening" act or incident can extinguish proximate cause. *Queen City*, 73 Ohio St. 3d at 619. It will not do so, however, if the defendants could have "reasonably foreseen" that the "intervening event" was "likely to happen." *Taylor v. Webster*, 12 Ohio St. 2d 53, syllabus ¶2, 231 N.E.2d 870 (1967).

"There [also] may be more than one proximate cause of an injury." *Taylor*, 12 Ohio St. 2d at 57; *accord*, *Murphy v. Carrolton Mftg. Co.*, 61 Ohio St. 3d 585, 588, 575 N.E.2d 828 (1991). This circumstance arises where various forces (including the defendants' misconduct) each constitutes a "substantial factor" in causing the plaintiff's injury. *Queen City*, 73 Ohio St. 3d at 617.

V. The Court of Appeals' Decision

The court of appeals did not apply or even acknowledge any of these principles in determining that Cleveland failed to plead proximate cause. Instead, the court based its decision on the City's supposed inability to prove a "direct injury" resulting from the defendants' conduct. The court held that "the requirement of a direct injury is a 'central element' of proximate cause." *Id.* It drew this conclusion not from Ohio Supreme Court precedent but from *Perry v. American Tobacco Co.*, 324 F.3d 845 (6th Cir. 2003), a decision construing the requirement of proximate cause under the federal RICO statute. *Id.* at 848. The court reinforced this premise by turning to another RICO decision, *Holmes v. SIPC*, 503 U.S. 258 (1992):

> The directness requirement "requires some direct relation between the injury asserted and the injurious conduct alleged."

Pet App. 13a, *quoting Holmes*, 503 U.S. at 268.

The court of appeals asserted that the Ohio Supreme Court, in *City of Cincinnati v. Beretta USA Corp.*, 95 Ohio St. 3d 416, 768 N.E.2d 1136 (2002), "adopted ... the *Holmes* ... proximate cause analysis." Pet App. 13a. From this premise, the panel proceeded to evaluate Cleveland's pleading pursuant to the decision of this Court and its federal progeny. *Id.*, pp. 13a-21a The panel predicted that the Ohio Supreme Court would do likewise if confronted with the City's case, since it had "previously adopted the directness requirement" articulated in *Holmes*. *Id.*, p. 15a.

Beretta, however, did not abandon established proximate cause standards in favor of *Holmes*. The decision states only that in "*some* [unspecified] common law cases," the plaintiff must establish a "direct relation between the injury asserted and injurious conduct alleged." 95 Ohio St. 3d at 426 (emphasis added). The court held as such in considering the issue of remoteness, not explicitly in connection with any proximate cause analysis. *Id.*

Following *Beretta*, not a single reported case construing Ohio common law enforces the "direct injury" test pursuant to either the Ohio Supreme Court decision or *Holmes*. Nor does any Ohio court cite the federal decisions ensuing from *Holmes* which underlie the court of appeals' finding that Cleveland had inadequately pled proximate cause. *See Anza v. Ideal Steel Sup. Corp.*, 547 U.S. 451 (2006); *Canyon Cty. v. Syngenta Seeds, Inc.*, 519 F.3d 969 (9th Cir.), *cert. denied*, 129 S.Ct. 458 (2008).

In predicting Ohio law based upon federal authorities, the court of appeals did not consider the possibility that injuries can have more than one proximate cause. *Murphy*, 61 Ohio St. 3d at 588. The court did not acknowledge that proximate cause may exist with respect to an "event causing injury [that] appears to have been closely related to the damage created by the [defendants'] original conduct." *Di Gildo*, 18 Ohio St. 2d at 130. The court also did not take into account the fact that "intervening events" reasonably foreseen by the defendants do not extinguish proximate causation. *Taylor*, syllabus ¶2. Each of these Ohio rules belies the court's finding that the absence of "direct injury" negated proximate cause.

The court of appeals' forecast concerning the preeminence of the "direct injury" standard also ignored what the Ohio Supreme Court had to say about *Holmes*. *Beretta* involved public nuisance claims brought by the City of Cincinnati against gun manufacturers over the way they produced and distributed their products. The Ohio Supreme Court found that a "direct" relation existed between Cincinnati's injury and the defendants' alleged wrongdoing. *See* 95 Ohio St. 3d at 427.

The court of appeals, however, chose essentially to forego any consideration of this analysis, which speaks directly to Cleveland's public nuisance claim, given the marked similarities between the two cases. Instead, the court distinguished *Beretta* based upon considerations extraneous to the Ohio Supreme Court's application of the "direct injury" test. Pet App. 18a-19a. In this respect, the court of appeals ignored *Beretta* in predicting how it would decide Cleveland's public nuisance case.

REASONS FOR GRANTING THE WRIT

I. The Court has never precisely identified the means by which federal courts should resolve unsettled issues of state law.

In *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938), the Court banished the practice of deciding diversity actions on the basis of "federal general common law." *Id.* at 78. The court in such cases must instead "apply the substantive law of the forum State, absent a federal statutory or constitutional directive to the contrary." *Salve Regina College v. Russell*, 499 U.S. 225, 226 (1991). The holding in *Erie* is "constitutionally compelled," and "not simply ... a salutary rule of judicial administration." *Allstate Ins. Co. v. Menards, Inc.*, 285 F.3d 630, 634 (7th Cir. 2002). The decision represents "one of the modern cornerstones of our federalism, expressing policies that profoundly touch the allocation of judicial power between the state and federal systems." *Hanna v. Plumer*, 380 U.S. 460, 474 (1965) (Harlan, J., concurring).

Erie recognizes the decisions of a state's "highest court" as the source of its common law. 304 U.S. at 78. The Court later held that in the absence of such controlling precedent, determination of state law may derive from lower state court decisions and other "available data." *West v. American Tel. & Tel.*, 311 U.S. 223, 237 (1940). The Court, however, has never precisely identified the means by which federal courts should resolve unsettled issues of state law.

II. The prediction of state law in diversity cases implicates fundamental tenets of federalism.

Lower federal courts, in fact, have "don[ned] the soothsayer's garb" to define state law in diversity cases where no state supreme court precedent directly applies. *Official Committee of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340, 349 (3d Cir. 2001). In such instances, federal judges undertake to "make an informed prophecy – to discern the rule the state's highest court would be most likely to follow under [the] circumstances." *Janney Montgomery Scott LLC v. Tobin*, 571 F.3d 162, 164 (1st Cir. 2009) (quotation marks omitted).[4]

This approach presents several potential pitfalls. Federal courts are frequently wrong in predicting state law in diversity cases. *See* DOLORES K. SLOVITER, "A FEDERAL JUDGE VIEWS DIVERSITY JURISDICTION

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[4] *See also Runner v. NYSE*, 568 F.3d 383, 386 (2d Cir. 2009); *Ellis v. Grant Thornton LLP*, 530 F.3d 280, 287 (4th Cir.), *cert. denied*, 129 S.Ct. 652 (2008); *Chaney v. Dreyfus Serv. Corp.*, 595 F.3d 219, 229 (5th Cir. 2010); *Mazur v. Young*, 507 F.3d 1013, 1016 (6th Cir. 2007); *Curtis Lumber Co. v. Louisiana Pac. Corp.*, 618 F.3d 762, 771-72 (8th Cir. 2010); *Giles v. General Mot. Acceptance Corp.*, 494 F.3d 865, 872 (9th Cir. 2007); *Williams v. United Parcel Serv.*, 527 F.3d 1135, 1140 (10th Cir. 2008); *CSX Trans. v. Trism Specialized Carriers*, 182 F.3d 788, 790 (11th Cir. 1999).

THROUGH THE LENS OF FEDERALISM," 78 *VA. L. REV.* 1671, 1680-81 (1992). Erroneous rulings of this kind

> inevitably skew the decisions of persons and businesses who rely on them and inequitably affect the losing federal litigant who cannot appeal the decision to the state supreme court.

Id. at 1681. "[T]hey may even mislead lower state courts that may be inclined to accept federal predictions as applicable precedent." *Id.*

Moreover, federal courts lack any "inherent power to make state law, such as a state court might have." *Lexington Ins. Co. v. Rugg & Knopp, Inc.*, 165 F.3d 1087, 1093 (7th Cir. 1999). Their role in "diversity cases is to interpret state law, not to fashion it." *Orion Fin. Corp. v. American Foods Group*, 281 F.3d 733, 738 (8th Cir. 2002). They must rule as they think the state's highest court would, and not "do merely what [they] think best." *Calbillo v. Cavender Oldsmobile*, 288 F.3d 721, 729 (5th Cir. 2002) (quotation marks omitted).

Federal courts cannot blaze "new trails" or "significantly expand existing rules" of state law in deciding diversity cases. *Phoung Luc v. Wyndham Mgmt. Corp.*, 496 F.3d 85, 88-89 (1st Cir. 2007) (quotation marks omitted). They must avoid "elbow[ing]" their way into a "controversy to render what may be an uncertain and ephemeral interpretation of state law." *Time Warner Enter.-Advance/Newhouse Partnership v. Barteret-Craven Elec. Membership Corp.*, 506 F.3d 304, 314 (4th Cir. 2007) (quotation marks omitted).

As these considerations suggest, "when state law is unclear, efforts by federal courts to 'predict' how a state's highest court would rule raise judicial federalism concerns." *Michaels v. State of New Jersey*, 150 F.3d 257, 259 (3d Cir. 1998) (Alito, J.) (quotation marks omitted). Such "predictions" intrinsically create the "potential for significant intrusion" upon states' exclusive authority to establish and develop state law. *Menards*, 285 F.3d at 638. What begins as "prediction" frequently transforms into "state lawmaking by federal courts," where decisions meaningfully alter the trajectory of existing jurisprudence. *See* SLOVITER, 78 *VA. L. REV.* at 1687. This "state lawmaking" comes from federal judges "who are not selected under the state's system and who are not answerable to its constituency." *Id.*

Moreover, taking place in the absence of binding state precedent, federal "'prediction' of state law" may effectively involve "little more than a choice among competing policy considerations" – an exercise uniquely within the province of the states themselves. *See* BRADFORD R. CLARK, "ASCERTAINING THE LAWS OF THE SEVERAL STATES: POSITIVISM AND JUDICIAL FEDERALISM AFTER ERIE," 145 *U. PA. L. REV.* 1459, 1499 (1997). By performing this role, federal courts "prevent the informed evolution of state policy by state tribunals." *Todd v. Societe Bic, S.A.*, 21 F.3d 1402 (7th Cir.), *cert. denied*, 513 U.S. 947 (1994), *quoting Moore v. Sims*, 442 U.S. 415, 429-30 (1979).

The court of appeals' decision presents a case in point. Faced with a unique fact pattern, the court putatively extrapolated from existing Ohio precedent to formulate a workable standard for assessing proximate cause. The result, however, either obviated, obscured, or deviated from longstanding principles articulated by the Ohio Supreme Court. The court of appeals explained that it was trying to "anticipate" how the Ohio Supreme Court would treat Cleveland's claim for public nuisance. *See* Pet. App. 13a. In reality, it engaged in "state lawmaking" that dramatically changed controlling doctrine under Ohio law. *See* SLOVITER, 78 *VA. L. REV.* at 1687.

In the process, the court of appeals derailed a lawsuit where substantial state interests were at stake. Cleveland's public nuisance claim addresses the nature and extent of cities' right to redress in the wake of the subprime foreclosure crisis. This is an emerging issue with broad-ranging implications. *See generally* RAYMOND H. BRESCIA, "TAINTED LOANS: THE VALUE OF A MASS TORTS APPROACH IN SUBPRIME MTG. LITIG.," 78 *U. CIN. L. REV.* 1 (2009). Its resolution should come from the "informed evolution of state policy in state tribunals," rather than a federal court's usurpation of this function. *See Todd*, 21 F.3d at 1414.

III. Federal courts effectively reinstate the practice banned in *Erie* when they make a state-law prediction based on federal decisions interpreting federal law.

The court of appeals' "prediction" of Ohio law becomes particularly objectionable in light of its reliance upon federal precedent interpreting federal law. Ordinarily, lower courts look to "relevant state precedents, analogous decisions, ... dicta, [and] scholarly works," among "other reliable data," in attempting to prognosticate how "the highest court in the state" would resolve open questions of law. *Wayne Moving & Storage v. School Dist.*, 625 F.3d 148, 154

(3d Cir. 2010); *see also Janney*, 571 F.3d at 164; *Curtis Lumber Co.*, 618 F.3d at 771. In this vein, they have considered "federal cases interpreting state law." *Canal Ins. Co. v. Underwriters at Lloyd's London*, 435 F.3d 431, 436 (7th Cir. 2006); *see also Chase Manhattan Bank v. T&N plc*, 905 F. Supp. 114 (S.D.N.Y. 1995).

Yet federal courts reinstate the protocol banned by *Erie* when they make state-law "predictions" based on federal decisions construing federal law. "[F]ederal general common law" effectively controls in such situations, rather than any semblance of state-law principles. *Erie*, 304 U.S. at 78. By proceeding in this fashion, federal courts seize for themselves the authority to "exercise an independent judgment as to what the common law of the state is – or should be." *Id.* at 71. These circumstances obviously tread upon the principles of federalism. *See Boyle v. United Tech. Corp.*, 487 U.S. 500, 517 (1988) (Brennan, J., dissenting) (federal courts "seriously implicate[ ]" such concerns when they "displace the state law that would ordinarily govern with their own rules of federal common law").

IV. The Court should hold that federal courts may not predict state law in diversity cases on the basis of federal precedent interpreting federal law, absent an explicit directive from the state's highest court to proceed in this fashion.

The Court "has never squarely endorsed the predictive approach" for resolving uncertain issues of state law in diversity cases. CLARK, 145 *U. PA. L. REV.*

at 1495.[5] It also has never set any standards for lower courts' use of this method to discharge their responsibilities under *Erie*. A compelling need arises for such guidance, given the "potential for significant intrusion" upon states' constitutional prerogatives and the potentially "disastrous" consequences of an erroneous "prediction." *See Menards*, 285 F.3d at 638. The court of appeals' decision especially cries out for review, given the "state lawmaking" that it embodies and its implicit hostility to *Erie* and the fundamental tenets of federalism. *See* SLOVITER, 78 *VA. L. REV.* at 1687.

The Court should hold that federal courts may not predict state law in diversity cases on the basis of federal precedent interpreting federal law, absent an explicit directive from the state's highest court to proceed in this fashion. Such a rule would vindicate *Erie* by ensuring that "federal general common law" does not return as the basis for deciding these cases. *Erie*, 304 U.S. at 78. It would encourage closer adherence to the state authorities that should control in diversity cases, thereby reducing the prospect for federal encroachment upon states' lawmaking function. And it would enable the Court to rectify the injustice done in this action, where the overreaching application of federal law served to vanquish an important state-law claim.

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[5] *But see Bernhardt v. Polygraphic Co.*, 350 U.S. 198, 209 (1956) (Frankfurter, J., concurring) ("As long as there is diversity jurisdiction, 'estimates' are necessarily often all that federal courts can make in ascertaining what the state could would rule to be its law").

CONCLUSION

The court of appeals' decision implicates *Erie* and the principles of federalism that *Erie* vindicates. For the reasons discussed above, the Court should grant this petition for certiorari.

Respectfully submitted,

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APPENDIX

TABLE OF CONTENTS

Appendix A: Opinion, United States Court of Appeals for the Sixth Circuit, (July 27, 2010) 1a

Appendix B: Memorandum Opinion and Order, United States District Court Northern District of Ohio Eastern Division, (May 15, 2009) 24a

Appendix C: Order, United States Court of Appeals for the Sixth Circuit, (October 14, 2010) 73a

Appendix D: Fed. R. Civ. P. 12 . . . . 75a

Appendix E: Second Amended Complaint (Jury Demand Endorsed Hereon), United States District Court Northern District of Ohio Eastern Division, (October 8, 2008) 80a

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APPENDIX A

RECOMMENDED FOR FULL-TEXT
PUBLICATION
Pursuant to Sixth Circuit Rule 206

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 09-3608

[Filed July 27, 2010]

CITY OF CLEVELAND,
Plaintiff-Appellant,

v.

AMERIQUEST MORTGAGE SECURITIES,
INC.; BEAR STEARNS & CO., INC.;
CITIGROUP GLOBAL MARKETS, INC.;
COUNTRYWIDE SECURITIES
CORPORATION; CREDIT SUISSE FIRST
BOSTON LLC; CREDIT SUISSE (USA),
INC.; GOLDMAN SACHS & CO.;
DEUTSCHE BANK SECURITIES, INC.;
GREENWICH CAPITAL MARKETS, INC.;
GMAC-RFC; HSBC SECURITIES (USA),
INC.; JP MORGAN ACQUISITION CORP.;
MERRILL LYNCH, PIERCE, FENNER &
SMITH, INCORPORATED; MORGAN
STANLEY & CO., INC.; NOVASTAR
MORTGAGE, INC.; OPTION ONE

MORTGAGE CORPORATION;)
WASHINGTON MUTUAL BANK; WELLS)
FARGO BANK, N.A.; WELLS FARGO)
ASSET SECURITIES CORPORATION;)
CITIBANK, N.A.; CHASE BANK USA,)
N.A.; BANK OF AMERICA, N.A.,)
Defendants-Appellees.)

Appeal from the United States District Court
for the Northern District of Ohio at Cleveland.
No. 08-00139—Sara E. Lioi, District Judge.

Argued: April 27, 2010

Decided and Filed: July 27, 2010

Before: SUHRHEINRICH, McKEAGUE, and
GRIFFIN, Circuit Judges.

COUNSEL

ARGUED: Joshua R. Cohen, COHEN ROSENTHAL & KRAMER LLP, Cleveland, Ohio, for Appellant. David F. Adler, JONES DAY, Cleveland, Ohio, for Appellees. **ON BRIEF:** Joshua R. Cohen, Jason R. Bristol, COHEN ROSENTHAL & KRAMER LLP, Cleveland, Ohio, Robert J. Triozzi, Gary S. Singletary, Michael F. Cosgrove, CITY OF CLEVELAND LAW DEPARTMENT, Cleveland, Ohio, for Appellant. David F. Adler, Andrew G. Fiorella, JONES DAY, Cleveland, Ohio, Louis A. Chaiten, Eric E. Murphy, JONES DAY, Columbus, Ohio, Robert D. Kehoe, Joseph J. Jerse, KEHOE & ASSOCIATES, Cleveland, Ohio, Joanne N. Davies, BUCHALTER NEMER, Irvine, California, Bernard LeSage, Shannon Keast, BUCHALTER NEMER, Los Angeles, California, Michael N. Ungar, Isaac Schulz, Richik Sarkar, ULMER & BERNE, Cleveland, Ohio, Brian D. Boyle, Christopher D. Catalano, O'MELVENY & MYERS LLP, Washington, D.C., William H. Falin, MOSCARINO & TREU, Cleveland, Ohio, Charles E. Davidow, PAUL WEISS RIFKIND WHARTON & GARRISON, Washington, D.C., Gabrielle E. Tenzer, PAUL WEISS RIFKIND WHARTON & GARRISON, New York, New York, William W. Jacobs, Kip Thomas Bollin, Robin M. Wilson, THOMPSON HINE, Cleveland, Ohio, Jeffrey Q. Smith, Scott E. Eckas, BINGHAM McCUTCHEN LLP, New York, New York, Richard H. Klapper, Michael T. Tomaino, Jr., SULLIVAN & CROMWELL LLP, New York, New York, W. Stuart Dornette, TAFT STETTINIUS & HOLLISTER LLP, Cincinnati, Ohio, Stephen M. O'Bryan, TAFT STETTINIUS & HOLLISTER LLP, Cleveland, Ohio, Thomas Robert Lucchesi, BAKER & HOSTETLER LLP, Cleveland, Ohio, Benjamin Klubes, BUCKLEY SANDLER LLP, Washington, D.C., David H. Kistenbroker, Theresa L. Davis, KATTEN MUCHIN ROSENMAN LLP, Chicago, Illinois, Robert B. Casarona, ROETZEL & ANDRESS, LPA, Cleveland, Ohio, Robert N. Rapp, CALFEE, HALTER & GRISWOLD LLP, Cleveland, Ohio, Jay B. Kasner, SKADDEN, ARPS, SLATE, MEAGHER & FLOM, New York, New York, Joseph L. Barloon, SKADDEN, ARPS, SLATE, MEAGHER & FLOM, Washington, D.C., John F. Marsh, HAHN LOESER & PARKS, Columbus, Ohio, Brian Brooks, O'MELVENY & MEYERS, Washington, D.C., Elizabeth McKeen, O'MELVENY & MEYERS, Newport Beach, California, Joseph T. Dattilo, BROUSE McDOWELL, Cleveland, Ohio, Patrick M. McLaughlin, McLAUGHLIN &

McCAFFREY, LLP, Cleveland, Ohio, Robert D. Wick, Keith A. Noreika, COVINGTON & BURLING LLP, Washington, D.C., for Appellees. Linda I. Cook, OHIO POVERTY LAW CENTER, Columbus, Ohio, Eugene L. Hollins, Dale D. Cook, WILES, BOYLE, BURKHOLDER & BRINGARDNER CO., L.P.A., Columbus, Ohio, for Amici Curiae.

OPINION

SUHRHEINRICH, Circuit Judge. In this diversity case, the city of Cleveland, Ohio ("Cleveland"), brings a public nuisance suit against twenty-two financial entities ("Defendants") that it claims are responsible for a large portion of the subprime lending market in Cleveland and nationally.[1] Cleveland argues that the Defendants' financing of subprime mortgages, the alleged public nuisance, led to a foreclosure crisis in Cleveland that devastated its neighborhoods and economy. On appeal, Cleveland initially contends that the district court erred when it refused to remand this suit to Ohio state court. It also appeals, on the merits, the district court's four independent reasons for dismissing this suit pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure: (1) preemption, (2) the economic loss rule, (3) unreasonable interference of a public right, and (4) proximate cause. The district court considered each reason to be dispositive in favor of all Defendants. For the reasons that follow, we **AFFIRM**.

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[1] In Ohio, a public nuisance is defined as "an unreasonable interference with a right common to the general public." *Cincinnati v. Beretta U.S.A. Corp.*, 768 N.E.2d 1136, 1142 (Ohio 2002) (quoting Restatement (Second) of Torts § 821B(1)).

I. Background

A. Factual Background

In its complaint, Cleveland acknowledges that, for the most part, the Defendants did not originate the subprime mortgages at issue in this appeal. Nevertheless, it alleges that the Defendants' financing, purchasing, and pooling of vast amounts of these loans, to create mortgage-backed securities to sell to their customers, constituted a public nuisance. Cleveland puts forward the following factual pattern to support its claim:

> (1) Wall Street made cash available to subprime lenders, which (2) used the funds to make subprime loans to consumers, then (3) sold the related mortgages back to the same cadre of Wall Street, which (4) packaged them and sold the income they generated to investors in the form of mortgage-backed securities, and (5) used the proceeds to repeat the process.

Cleveland maintains that, beginning in 2003, the Defendants became more brazen in their lending activities and began to direct lenders on the types of loans to issue to meet the Defendants' securitization needs. These pressures "subverted the normal operation of the mortgage market and inevitably led to the abandonment of meaningful underwriting standards." Because of growth in the real-estate market, the Defendants ignored these issues and turned a blind-eye even when loans made no economic sense. The complaint concludes that these "securitizers" were principally responsible for the financial crisis.

Cleveland alleges that the factors that led to the housing bubble never materialized in Cleveland because of its high rate of poverty, sluggish job market, struggling Rust-Belt economy, declining manufacturing sector, sparse housing demand, and difficulty fostering new industries. Cleveland's unique economic plight and its stagnant housing market made mass foreclosures the foreseeable and inevitable result of the subprime financing provided by the Defendants. The Defendants knew about these unique issues but nevertheless continued to finance subprime mortgages in Cleveland. These activities led to thousands of foreclosed homes in neighborhoods throughout Cleveland that became "eyesores, fire hazards, and easy prey for looters and drug dealers in search of a place to conduct their business."

Cleveland claims that each foreclosure creates tangible costs for the city, including increased expenditures for fire and police protection and maintenance and demolition costs. Tax revenues also plummeted because of the decline in housing values due to the foreclosed homes. Cleveland seeks to recover millions in municipal expenditures and diminished tax revenues as damages.

B. Procedural Background

Cleveland filed suit on January 10, 2008, in the Court of Common Pleas for Cuyahoga County, Ohio. It brought a single claim of public nuisance against twenty-one defendants—some of which are current

Defendants. Asserting diversity of citizenship, Lehman Brothers Holdings, Inc. ("Lehman Brothers"),[2] removed the suit to the Northern District of Ohio on January 16, 2008. Cleveland moved the next day to remand the case to state court. It argued that Lehman Brothers's removal was improper because Lehman Brothers was required to either obtain the unanimous consent of all of the defendants before removing the case or explain in its Notice of Removal why it did not pursue this course of action. All of the defendants joined a motion opposing the motion to remand shortly thereafter. After supplemental briefing and oral argument, the district court denied Cleveland's motion to remand on August 8, 2008. *City of Cleveland v. Deutsche Bank Trust Co.*, 571 F. Supp. 2d 807 (N.D. Ohio 2008).

Subsequently, Cleveland filed a new public nuisance claim in state court. It made allegations similar to those found in the original complaint but brought the suit against some new defendants and some affiliates of the original defendants. For example, Countrywide Financial Corp. was a defendant in the original suit, but Cleveland sued Countrywide Home Loans, Inc. and Countrywide Securities Corp. in its new state court suit. A Joint Motion for Entry of Agreed Order Regarding Plaintiff's Motion for Leave to Amend ("Joint Motion") was then agreed to,[3] which the district court approved. The

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[2] Lehman Brothers is no longer a Defendant.

[3] Cleveland entered into a separate agreement with Wells Fargo Bank, N.A. and Wells Fargo Asset Securities Corporation, where it also agreed to pursue all claims "in federal court in the federal

Joint Motion was intended "to resolve the disagreement that has arisen between the parties and to avoid protracted litigation . . . ." *City of Cleveland v. Deutsche Bank Trust Co.*, No. 1:08-CV-00139 (N.D. Ohio September 29, 2008) (order approving Joint Motion). Among other things, it limited which defendants Cleveland could sue. Afterwards, Cleveland filed its Second Amended complaint in federal court—the complaint at issue in this appeal—against the current Defendants.

Defendants filed eight separate motions to dismiss—some individually and some collectively. The district court dismissed the complaint pursuant to Rule 12(b)(6) on May 15, 2009, for four independent reasons. *City of Cleveland v. Ameriquest Mortg. Sec., Inc.*, 621 F. Supp. 2d 513 (N.D. Ohio 2009). First, the court held that Ohio Rev. Code § 1.63, an Ohio state law that forbids municipalities from engaging in mortgage regulation, preempted Cleveland's public nuisance claim. *Id.* at 520. Second, the court held that Ohio's economic loss rule barred Cleveland's claim. *Id.* at 526. Third, the court held that subprime lending cannot form the basis of a public nuisance claim because it is legal, and that, by extension, funding subprime lending also cannot be a public nuisance. *Id.* at 531. Fourth, the court held that the assertions in Cleveland's complaint were insufficient to satisfy the directness requirement of proximate cause because its allegations did not "demonstrate any direct relationship between its alleged injury and [the] Defendants' conduct." *Id.* at 533. The court declined

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nuisance action." GMAC-RFC was not a party to the Joint Motion.

to rule on the other four motions because it found its rulings on the four issues it considered to be dispositive for all of the Defendants. *Id.* at 516. Cleveland appeals.

II. Analysis

A. Motion to Remand

Cleveland argues that the district court should have remanded this case to Ohio court because the Defendants' removal was defective. However, Cleveland waived its right to pursue this issue on appeal because the Joint Motion contained a clause that stated: "Plaintiff shall prosecute the public nuisance claim against the Eliminated Defendants and the Amended Defendants, if at all, exclusively in this Court and as part of this case . . . ."[4] It is well-established that the waiver of a party's right to removal must be clear and unequivocal. *See, e.g., Cadle Co. v. Reiner, Reiner & Bendett, P.C.*, 307 F. App'x 884, 886 (6th Cir. 2009). Further, "[g]eneral principles of contract interpretation apply when determining whether a clause explicitly waives the right of removal." *Id.* (citing *In re Delta Am. Re Ins. Co.*, 900 F.2d 890, 892 (6th Cir. 1990)).

Here, there is no plausible way to read this language as anything other than a clear and unequivocal waiver of Cleveland's right to further pursue its motion to remand on appeal, and Cleveland neither contests the validity of the Joint Motion nor suggests an alternative reading of this clause.[5] Instead, Cleveland contends that, despite the express language in the Joint Motion, it did not waive its right to appeal this ruling because it made a tactical decision based on time and money to enter into the agreement. These reasons are inadequate to void the agreement under the general principles of contract law. Therefore, the Joint Motion precludes Cleveland from now arguing that the district court should have remanded this suit, and the district court properly permitted this case to proceed in federal court.

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[4] All of the current Defendants were parties in the Joint Motion and were listed as either Amended Defendants or Eliminated Defendants, except for GMAC-RFC. GMAC-RFC was not a party to the Joint Motion, and was neither an Amended Defendant nor an Eliminated Defendant.

Furthermore, even if we ignore the Joint Motion, the district court still properly declined to remand this case. We review a district court's refusal to remand de novo. *Harper v. AutoAlliance Int'l, Inc.*, 392 F.3d 195, 200 (6th Cir. 2004). Cleveland argues that the district court's ruling did not conform with the rule of unanimity. The "rule of unanimity demands that all defendants must join in a petition to remove a state case to federal court." *Loftis v. United Parcel Serv., Inc.*, 342 F.3d 509, 516 (6th Cir. 2003). This circuit has identified at least three ways to satisfy this rule: all parties that have been served or otherwise properly joined may (1) join in the removal, (2) file a written consent to removal, or (3) oppose a motion to remand.

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[5] Cleveland could have contested the effect of the Joint Motion on its claim against GMAC-RFC. However, Cleveland has not made this argument in its briefs or at oral argument, so it is waived. *See Farm Labor Org. Comm. v. Ohio State Highway Patrol*, 308 F.3d 523, 544 n.8 (6th Cir. 2002) ("It is well established that an issue not raised in a party's briefs on appeal may be deemed waived.").

Brierly v. Alusuisse Flexible Packaging, Inc., 184 F.3d 527, 533 n.3 (6th Cir. 1999) (the first two options); *Harper*, 392 F.3d at 202 (the third option). The Defendants met two of these conditions. First, after Lehman Brothers filed its notice of removal on January 16, 2008, each Defendant filed a consent to removal, the last of which was filed February 1, 2008, within the thirty day period. Second, after Cleveland filed its motion to remand on January 17, 2008, all of the Defendants opposed Cleveland's motion to remand on February 1, 2008, also within the thirty day period.

We note that Cleveland has waived its argument that the rule of unanimity was violated because Bear Stearns's consent to removal was invalid. At oral argument, Cleveland conceded that it had purposefully waited to raise this argument until oral argument for its motion to remand, while believing that its general motion for remand would allow it to challenge Bear Stearns's consent after thirty days. Cleveland employed this suspect approach despite indicating in its Reply Brief in Support of Motion for Remand, filed on February 8, 2008, that "[a]ll of the defendants did eventually give their consent to removal." Because the argument raised by Cleveland at oral argument is inconsistent with the arguments it made during the thirty day period, it has waived its objection to Bear Stearns's consent. *See Mellon v. Int'l Shoe Co.*, 32 F.2d 390, 391 (D. Mass. 1929) ("This action was entirely inconsistent with the position taken in the motion to remand, and, having been done without any reservation of rights under the motion, had the effect of waiving the motion."). In any case, Bear Stearns also joined the opposition to remand, as did all of the Defendants, and this action alone was sufficient to satisfy the rule of unanimity.

Thus, we now turn to the district court's dismissal of this suit pursuant to Rule 12(b)(6). For the sake of judicial efficiency, we begin, and end, our analysis with the district court's proximate cause ruling.

B. Standard of Review

We review de novo the district court's dismissal pursuant to Rule 12(b)(6). *Mezibov v. Allen*, 411 F.3d 712, 716 (6th Cir. 2005). We construe the complaint in a light most favorable to the nonmoving party and accept all plausible well-pled factual allegations as true. *Bell Atl. Corp. v.* Twombly, 550 U.S. 544, 556 (2007), and *Commercial Money Ctr., Inc. v. Ill. Union Ins. Co.*, 508 F.3d 327, 336 (6th Cir. 2007). "To state a valid claim, a complaint must contain direct or inferential allegations respecting all the material elements under some viable legal theory." *Id.* at 336-37 (citing *Mezibov*, 411 F.3d at 716).

C. Applicable Law

Because this suit is before us pursuant to our diversity jurisdiction, we apply the substantive law of Ohio and federal procedural law. *Biegas v. Quickway Carriers, Inc.*, 573 F.3d 365, 374 (6th Cir. 2009). When applying the substantive law of Ohio, we must "follow the decisions of the state's highest court when that court has addressed the relevant issue." *Savedoff v. Access Group, Inc.*, 524 F.3d 754, 762 (6th Cir. 2008) (quoting *Talley v. State Farm Fire & Cas. Co.*, 223 F.3d 323, 326 (6th Cir. 2000)). "If the issue has not been directly addressed, we must 'anticipate how the relevant state's highest court would rule in the case and are bound by controlling decisions of that court."

Id. (quoting *In re Dow Corning Corp.*, 419 F.3d 543, 549 (6th Cir. 2005)).

D. Proximate Cause

Cleveland argues that its complaint alleged facts sufficient to satisfy the directness requirement. The directness requirement "requires some direct relation between the injury asserted and the injurious conduct alleged." *Holmes v. Sec. Investor Prot. Corp.*, 503 U.S. 258, 268 (1992). Although not the sole element, the requirement of a direct injury is a "central element" of proximate cause. *Perry v. Am. Tobacco Co.*, 324 F.3d 845, 848 (6th Cir. 2003). Notably, this requirement is distinct from foreseeability and applies even if the Defendants intentionally caused the alleged course of events. *Id.* at 850. Accordingly, although Cleveland asserts that the Defendants knew about the consequences of subprime lending, this allegation is not relevant to our directness requirement analysis.

Holmes is the seminal United States Supreme Court decision that discusses the directness requirement, and the Ohio Supreme Court has adopted the *Holmes* Court's proximate cause analysis. *Cincinnati v. Beretta U.S.A. Corp.*, 768 N.E.2d 1136, 1148-49 (Ohio 2002). *Holmes* is therefore the focus of our directness requirement analysis. In *Holmes*, the plaintiff, Securities Investor Protection Corporation ("SIPC"), brought suit against several defendants under the Racketeer Influenced and Corrupt Organizations Act ("RICO"). *Holmes*, 503 U.S. at 262. SIPC alleged that these defendants conspired to fraudulently manipulate stocks, which led to the insolvency of two securities broker-dealers. *Id.* at 261. As a result, the broker-dealers failed to satisfy their financial obligations to their customers, and SIPC, a provider of insurance to bankrupt broker-dealers that could no longer pay their customers, was forced to cover the broker-dealers' debts. *Id.* at 262-63. SIPC sued for reimbursement, but the Court declined to find liability because "the link [was] too remote between the stock manipulation alleged and the customers' harm, being purely contingent on the harm suffered by the broker-dealers." *Id.* at 271.

In *Beretta*, the Ohio Supreme Court summarized the three reasons given in *Holmes* for a directness requirement:

> (1) indirectness adds to the difficulty in determining which of the plaintiff's damages can be attributed to the defendant's misconduct, (2) recognizing the claims of the indirectly injured would complicate the apportionment of damages among plaintiffs to avoid multiple recoveries, and (3) these complications are unwarranted given the availability of other parties who are directly injured and who can remedy the harm without these associated problems.

Beretta, 768 N.E.2d at 1148 (citing *Holmes*, 503 U.S. at 269-70). The United States Supreme Court has since noted that these factors in *Holmes* are relevant to determine whether a plaintiff has sufficiently pleaded proximate cause, but all three factors do not need to be present for remoteness to bar recovery. *Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451, 459 (2006) (noting that the second factor was not implicated yet still holding that the plaintiff had failed to sufficiently allege proximate cause).

As an initial matter, Cleveland contends that the district court's proximate cause analysis at the motion to dismiss stage was premature. As support, it cites this court's decision in *Trollinger v. Tyson Foods, Inc.*, 370 F.3d 602 (6th Cir. 2004). In that case, former employees of a poultry plant sued under RICO, and alleged that the defendant, the poultry plant owner, schemed with employment agencies to depress wages by hiring illegal immigrants. *Id.* We refrained from engaging in a proximate cause analysis at the pleadings stage because we perceived that the analysis would be too speculative. *Id.* at 619. However, contrary to Cleveland's suggestions otherwise, there is no per se rule against dismissing a complaint for failure to adequately plead proximate cause. In fact, subsequent to *Trollinger*, the Supreme Court dismissed the complaint in *Anza* at the motion to dismiss stage for failure to plead proximate cause. *See Anza*, 547 U.S. at 453. Cleveland still has an obligation to file a complaint that is "plausible on its face." *Bell*, 550 U.S. at 556. Accordingly, we, just as the Supreme Court in *Anza*, proceed to the question of whether the complaint sufficiently pleaded proximate cause and, specifically, whether the allegations in the complaint satisfy the directness requirement.

For the purposes of answering this question, the Supreme Court's application of *Holmes* in its subsequent decision *Anza* is instructive and consistent with how we believe the Ohio Supreme Court would consider this matter because the Ohio Supreme Court has previously adopted the directness requirement precedent of the United States Supreme Court. *See Savedoff*, 524 F.3d at 762 (when a state's highest court has not addressed an issue, we anticipate how that court would rule). In *Anza*, the United States

Supreme Court considered the private RICO claim of the plaintiff, Ideal, which alleged that the defendant, National, engaged in mail and wire fraud that led to lost sales at the plaintiff's business. *Anza*, 547 U.S. at 453. Specifically, the plaintiff alleged that the defendant defrauded the New York tax authority and used the proceeds from this fraud to offer lower prices to its customers, which led to the plaintiff's lower sales because Ideal and National were competitors. *Id.* at 457-58. The Court held that the complaint did not satisfy the directness requirement because the alleged violation did not lead directly to the plaintiff's injuries. *Id.* at 461. It reasoned: "The cause of Ideal's asserted harms . . . is a set of actions (offering lower prices) entirely distinct from the alleged RICO violation (defrauding the State)." *Id.* at 458.

Similarly, here, the cause of the alleged harms is a set of actions (neglect of property, starting fires, looting, and dealing drugs) that is completely distinct from the asserted misconduct (financing subprime loans). *See id.*; *see also Canyon County v. Syngenta Seeds, Inc.*, 519 F.3d 969, 982 (9th Cir. 2008) ("Here, just as in *Anza*, the cause of the plaintiff's asserted harms is a set of actions (increased demand by people within Canyon County for public health care and law enforcement services) entirely distinct from the alleged RICO violation (the defendants' knowing hiring of undocumented workers)."). This lack of directness exposes "the difficulty that can arise when a court attempts to ascertain the damages caused by some remote action." *Id.* (citing *Holmes*, 503 U.S. at 269 ("[T]he less direct an injury is, the more difficult it becomes to ascertain the amount of a plaintiff's damages attributable to the violation, as distinct from other, independent, factors.")).

Just as in *Anza*, "[t]his conclusion is confirmed by considering the directness requirement's underlying premises." *Id.* Of the three *Holmes* factors, the first and third factors are squarely implicated by the facts alleged in the complaint. We begin with an analysis of the first factor, which states that indirectness adds to the difficulty of determining which damages can be attributed to the defendant's misconduct. *See Beretta*, 768 N.E.2d at 1148 (summarizing the first *Holmes* factor). Again, *Anza* provides a useful comparison. In *Anza*, the Court noted that "[t]he injury Ideal alleges is its own loss of sales resulting from National's decreased prices for cash-paying customers. National, however, could have lowered its prices *for any number of reasons unconnected to the asserted pattern of fraud*." *Anza*, 547 U.S. at 458-59 (emphasis added).

Likewise, in this case, the injuries that Cleveland alleges could have been caused by many other factors unconnected to the Defendants' conduct. Companies that sold mortgages to home buyers decided which loans should be made and on what conditions. Although the complaint alleges that the Defendants sometimes dictated which types of loans to make, these companies ultimately made the decisions regarding where they would seek financing, which types of loans they would market and sell, and, once the mortgagee, whether to keep the mortgage or sell it to another buyer, such as one of the Defendants. Moreover, home buyers chose to enter into a subprime mortgage and to default on their loans. And, once the mortgagor defaulted, the mortgagee or his assigns chose to begin the foreclosure process. These voluntary choices were made for a variety of reasons unrelated to the Defendants.

The alleged damages that subsequently occurred—eyesores, fires, drug deals, and looting —were also not directly caused by the Defendants. Homeowners, whether the initial buyers or mortgagees that later took possession of a home, were responsible for maintaining their properties. Fires were likely started by negligent or malicious individuals or occurred because a home was poorly built. Drug dealers and looters made independent decisions to engage in that criminal conduct. Additionally, other companies not listed in the complaint financed subprime loans and properties not subject to a subprime loan nevertheless entered into foreclosure. Similar to *Holmes* and *Anza*, Cleveland has not stated a viable claim when these actions could have occurred for "any number of reasons unconnected to the asserted pattern of [misconduct]." *Id.* at 458.

The involvement of so many independent actors also reveals why Cleveland's reliance on *Beretta* is misplaced. In that case, the Ohio Supreme Court allowed a lawsuit against handgun manufacturers, brought under numerous theories of liability including public nuisance, to proceed past the motion to dismiss stage. *Beretta*, 768 N.E.2d at 1140. But, in *Beretta*, the plaintiffs accused the defendants of creating and supplying an illegal firearms market in Cincinnati through their marketing, distribution, and selling of firearms. *Id.* at 1143. By contrast, the complaint concedes that, for the most part, the Defendants did not directly make subprime loans to the homeowners of Cleveland. The Defendants are instead accused of financing a legal market for these loans. Thus, for *Beretta* to be analogous to the instant case, the Ohio Supreme Court would have had to allow a suit against the banks that provided financing to the gun manufacturers that allegedly created the illegal secondary market. Because there is another set of independent actors between the alleged misconduct and the alleged injury, the proximate cause holding in that case does not logically extend to this one.[6]

Another similar reason that the complaint does not satisfy the directness requirement, which also touches on the concerns implicated by the first *Holmes* factor, is that the remote connection between the alleged misconduct and the alleged injury makes it impossible "to ascertain the amount of [Cleveland's] damages attributable to the violation." *See Holmes*, 503 U.S. at 269. The Court's reasoning in *Anza* is once more instructive:

> There is, in addition, a second discontinuity between the RICO violation and the asserted injury. Ideal's lost sales could have resulted from factors other than petitioners' alleged acts of fraud. Businesses lose and gain customers for many reasons, and it would require a complex assessment to establish what portion of Ideal's lost sales were the product of National's decreased prices. . . . The attenuated connection between Ideal's injury and the Anzas' injurious conduct thus implicates fundamental concerns expressed in *Holmes*.

Anza, 547 U.S. at 459 (internal citations omitted).

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[6] Although not relevant to the directness requirement, there is at least one other critical difference between this case and *Beretta*. The complaint in *Beretta* accused the defendants of financing an *illegal* market for guns, whereas, here, the Defendants allegedly financed a *legal* subprime mortgage market.

Just as in *Anza*, this case "implicates fundamental concerns expressed in *Holmes*." *Id.* A "complex assessment" would be needed to determine which municipal expenditures increased and tax revenues decreased because of the ills caused by foreclosed homes rather than, *inter alia*, job losses due to the decline in manufacturing, fickle consumer tastes, deteriorating schools, a national recession, or increases in crime not related to foreclosures. *Id.* Cleveland points to many of these factors in its brief to demonstrate why the Defendants should have known to avoid financing subprime loans in Cleveland, but these same reasons make it impossible for Cleveland to plead proximate cause under Ohio law. *See id.* ("Further illustrating this point is the speculative nature of the proceedings that would follow if Ideal were permitted to maintain its claim."); *see also Canyon County*, 519 F.3d at 983 ("The causal chain would also be difficult to ascertain because there are numerous alternative causes that might be the actual source or sources of the County's alleged harm.").

Finally, Cleveland's claim fails because, in accordance with *Holmes's* third factor, more immediate victims can sue to the extent that the Defendants violated any laws. *See Anza*, 547 U.S. at 460 ("The requirement of a direct causal connection is especially warranted where the immediate victims . . . can be expected to vindicate the laws by pursuing their own claims."). The Supreme Court explained in *Anza* that when the adjudication of another party's claim would be "relatively straightforward" and "considerably easier," "[t]here is no need to broaden the universe of actionable harms to permit . . . suits by parties who have been injured only indirectly." *Id.* Here, a suit brought by a mortgagor whose home has been foreclosed on would be "relatively straighforward" and damages would be "considerably easier" to calculate because the mortgagor could limit his suit to the the specific Defendants that financed his subprime loan or loans. Additionally, other home owners who were injured because their neighborhood declined due to foreclosed homes, while not necessarily immediate victims, are closer in the alleged chain of causation than Cleveland. It would be easier to calculate the damages suffered by property owners in a specific neighborhood, where the court could more readily ascertain how many foreclosures occurred and what caused them, than to calculate the damages to the whole city of Cleveland. And, to the extent that misconduct occurred when the Defendants sold mortgages to create mortgage-backed securities, the buyers of these securities can bring their own causes of action. These other potential claims obviate the need for this court to allow Cleveland's claim to proceed.

In sum, even when viewing the assertions in the complaint in a light most favorable to Cleveland, the connection between the alleged harm and the alleged misconduct is too indirect to warrant recovery. Although the facts are different than those before the Supreme Court in *Holmes* and *Anza,* the same directness concerns are implicated.

III. Conclusion

Our proximate cause holding clearly resolves this case, and we therefore do not need to address the district court's remaining reasons for dismissing the complaint. Accordingly, we **AFFIRM**.

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 09-3608

[Filed July 27, 2010]

CITY OF CLEVELAND,)
Plaintiff-Appellant,)
)
v.)
)
AMERIQUEST MORTGAGE SECURITIES,)
INC.; BEAR STEARNS & CO., INC.;)
CITIGROUP GLOBAL MARKETS, INC.;)
COUNTRYWIDE SECURITIES)
CORPORATION; CREDIT SUISSE FIRST)
BOSTON LLC; CREDIT SUISSE (USA),)
INC.; GOLDMAN SACHS & CO.;)
DEUTSCHE BANK SECURITIES, INC.;)
GREENWICH CAPITAL MARKETS, INC.;)
GMAC-RFC; HSBC SECURITIES (USA),)
INC.; JP MORGAN ACQUISITION CORP.;)
MERRILL LYNCH, PIERCE, FENNER &)
SMITH, INCORPORATED; MORGAN)
STANLEY & CO., INC.; NOVASTAR)
MORTGAGE, INC.; OPTION ONE)
MORTGAGE CORPORATION;)
WASHINGTON MUTUAL BANK; WELLS)
FARGO BANK, N.A.; WELLS FARGO)
ASSET SECURITIES CORPORATION;)
CITIBANK, N.A.; CHASE BANK USA,)
N.A.; BANK OF AMERICA, N.A.,)
Defendants-Appellees.)
)

Before: SUHRHEINRICH, MCKEAGUE, and
GRIFFIN, Circuit Judges.

JUDGMENT

On Appeal from the United States District Court
for the Northern District of Ohio at Cleveland.

THIS CAUSE was heard on the record from the district court and was argued by counsel.

IN CONSIDERATION WHEREOF, it is ORDERED that the judgment of the district court is AFFIRMED.

ENTERED BY ORDER OF THE COURT

/s/Leonard Green
Leonard Green, Clerk

APPENDIX B

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

CASE NO. 1:08 cv 139

JUDGE SARA LIOI

[Filed May 15, 2009]

CITY OF CLEVELAND,	)
	)
Plaintiff,	)
	)
vs.	)
	)
AMERIQUEST MORTGAGE SECURITIES, INC.; et al.,	))
	)
Defendants.	)
	)

MEMORANDUM OPINION AND ORDER

This matter comes before the Court on motions to dismiss pursuant to Rule 12(b)(6) filed by all defendants. The matter has been fully briefed and is ripe for decision.

I. Factual & Procedural Background

In its Second Amended Complaint ("SAC"), plaintiff City of Cleveland (the "City" or "Plaintiff") asserts a single public nuisance cause of action against each of the following corporate defendants: Ameriquest Mortgage Securities, Inc., Bank of America, N.A., Bear Stearns & Co., Inc., Citibank, N.A., Citigroup Global Markets, Inc., Countrywide Securities Corporation, Credit Suisse First Boston LLC, Credit Suisse (USA), Inc., Deutsche Bank Securities, Inc., GMAC-RFC Holding Company, Goldman Sachs & Co., Greenwich Capital Markets, Inc., HSBC Securities (USA), Inc., JP Morgan Acquisition Corp., Chase Bank USA, N.A., Merrill Lynch, Pierce, Fenner & Smith Inc., Morgan Stanley & Co., Inc., Novastar Mortgage, Inc., Option One Mortgage Corporation, Washington Mutual Bank, Wells Fargo Bank, N.A., and Wells Fargo Asset Securities Corporation (collectively, "Defendants").

Plaintiff blames subprime lending for the epidemic of foreclosures afflicting the City. Plaintiff claims that subprime lending was categorically inappropriate for Cleveland due to its "unique" economic situation, characterized by a high poverty rate, sluggish economy, limited employment opportunities, and stable but not booming property values. The SAC targets Defendants not for engaging in direct subprime lending, but instead for their alleged role in securitizing subprime loans into mortgage-backed securities ("MBS"). This allegation appears calculated to capture the related activities of (1) creating MBS by bundling together subprime loans and/or (2) providing the funding used to purchase the underlying loans. Plaintiff asserts that this conduct created a public nuisance, with the resulting spike in foreclosure activity being its foreseeable result. The City seeks to recover damages it claims are represented by (1) the cost of monitoring, maintaining, and demolishing foreclosed properties; and (2) the diminution in the City's property tax revenues caused by the depreciating effect foreclosures have had on the affected homes and surrounding properties.

Via eight separate motions to dismiss – some filed individually and others in combination – Defendants move to dismiss the SAC under Rule 12(b)(6) for failure to state a claim for relief.[1] Individual defendants and groups of defendants present numerous arguments in support of dismissal, some of which apply only to certain defendants.[2] All

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[1] Defendants filed a total of eight motions to dismiss:
Doc. No. 197 – Option One Mortgage Corp., Ameriquest Mortgage Securities, Inc., Countrywide Securities Corp., HSBC Securities (USA) Inc., Washington Mutual Bank, and Novastar Mortgage, Inc.
Doc. No. 199 – Greenwich Capital Markets, Inc., Morgan Stanley & Co., Inc., Credit Suisse Securities (USA) LLC, Credit Suisse (USA), Inc., Goldman Sachs & Co., and Merrill Lynch, Pierce, Fenner & Smith, Inc.
Doc. No. 202 – Wells Fargo Bank, N.A. and Wells Fargo Asset Securities Corporation
Doc. No. 205 – Citibank, N.A. and Citigroup Global Markets, Inc.
Doc. No. 207 – JP Morgan Acquisition Corp., Bear Stearns & Co., Inc., and Chase Bank USA, N.A.
Doc. No. 208 – Deutsche Bank Securities, Inc.
Doc. No. 209 – Bank of America, N.A.
Doc. No. 228 – GMAC-RFC Holding Company

[2] For instance, the Wells Fargo defendants argue that the City's claim is preempted by the National Bank Act, 12 U.S.C. § 21, *et seq*. (*See* Doc. Nos. 202 & 203.) Several defendants joined in this

Defendants, however, assert that the City's public nuisance claim fails because (a) it is preempted by Ohio law; (b) it is barred by the economic loss doctrine; (c) Plaintiff has not alleged interference with a public right; (d) Defendants' conduct did not constitute an unreasonable interference with a public right; and (e) the allegations in the SAC are insufficient to demonstrate proximate cause. The City filed a combined response in opposition to the motions to dismiss, and Defendants filed replies. In this memorandum, the Court addresses four of the aforementioned universally-applicable arguments raised by Defendants and, finding each of the four selected arguments independently sufficient to sustain the disposition of the case, declines to address Defendants' remaining contentions.[3]

II. Law & Analysis

A. Standard of Review

When reviewing a motion to dismiss for failure to state a claim, the court must construe the complaint in the light most favorable to the plaintiff, accept all well-pleaded factual allegations as true, and determine

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argument (*see* Doc. Nos. 205, 207, and 209), but it applies only to those defendants that are federally-chartered national banks.

[3] The Office of the Comptroller of the Currency ("OCC") filed a motion for leave to appear as *amicus curiae* in support of the Wells Fargo defendants. (Doc. No. 224.) In its memorandum, the OCC supports the National Bank Act preemption arguments raised by the Wells Fargo defendants. Because the Court does not address the federal preemption arguments, the OCC's motion for leave is denied as moot.

whether the moving party is entitled to judgment as a matter of law. *Commercial Money Ctr., Inc. v. Ill. Union Ins. Co.*, 508 F.3d 327, 336 (6th Cir. 2007) (citing *United States v. Moriarty*, 8 F.3d 329, 332 (1993)). To survive a motion to dismiss under Rule 12(b)(6), the complaint must contain "enough facts to state a claim to relief that is plausible on its face." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007). "Although this is a liberal pleading standard, it requires more than the bare assertion of legal conclusions. Rather, the complaint must contain either direct or inferential allegations respecting all the material elements to sustain a recovery under some viable legal theory." *First Am. Title Co. v. DeVaugh*, 480 F.3d 438, 444 (6th Cir. 2007) (quoting *Se. Tex. Inns, Inc. v. Prime Hospitality Corp.*, 462 F.3d 666, 671-72 (6th Cir. 2006)).

B. Choice of Law

This case is before the Court on diversity jurisdiction, 28 U.S.C. § 1332, so the choice of law rules of the forum state apply. *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 US. 487, 496 (1941); *Himmel v. Ford Motor Co.*, 342 F.3d 593, 598 (6th Cir. 2003). In cases involving alleged torts, the law of the place of injury is presumed to govern. *Morgan v. Biro Mfg. Co., Inc.*, 15 Ohio St. 3d 339, 341 (1984). Because Plaintiff seeks to recover for injuries that allegedly occurred in Cleveland, Ohio, Ohio law controls.

C. State Law Preemption

Defendants argue that the City's complaint is preempted by Ohio state law, specifically, Ohio Revised Code § 1.63, which states:

> The state solely shall regulate the business of originating, granting, servicing, and collecting loans and other forms of credit in the state and the manner in which any such business is conducted, and this regulation shall be in lieu of all other regulation of such activities by any municipal corporation or other political subdivision. Any ordinance, resolution, regulation, or other action by a municipal corporation or political subdivision to regulate, directly or indirectly, the origination, granting, servicing, or collection of loans or other forms of credit constitutes a conflict with the Revised Code, including, but not limited to, Titles XI, XIII, XVII, and XLVII, and with the uniform operation throughout the state of lending and other credit provisions, and is preempted.

Ohio Rev. Code § 1.63(A) – (B). Defendants maintain that the City's lawsuit is an "action by a municipal corporation [. . .] to regulate, directly or indirectly, the origination, granting, servicing, or collecting of loans or other forms of credit," and thus conflicts with the Ohio Revised Code, resulting in its preemption. The City responds by arguing that its public nuisance action is not a regulatory action, but simply an ordinary action to recover money or property, and therefore does not fall within the purview of § 1.63.[4] The Court agrees with Defendants.

The statute expressly covers "[a]ny ordinance, resolution, regulation, or *other action*," and thus preempts more than just traditional legislative and administrative efforts. Ohio Rev. Code § 1.63 (emphasis added). Without question, common law actions for damages represent an important manner of regulating conduct. *Riegel v. Medtronic, Inc.*, 128 S. Ct. 999, 1008 (2008) (citing *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 521 (1992)) (a common law action "limited to damages [. . .] 'can be, indeed is designed to be, a potent method of governing conduct and controlling policy.'"); *San Diego Bldg. Trades Council, Millmen's Union, Local 2020 v. Garmon*, 359 U.S. 236, 247 (1959) ("regulation can be as effectively exerted through an award of damages as through some form of preventive relief.")[5]

> The United States Supreme Court has recognized that the judicial process can be viewed as the extension of a government's

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[4] The City first argues that Ohio Rev. Code ¶ 1.63 does not preempt its claim because "[c]ourts may not presume that [a] statute was intended to abrogate the common law[,]" but instead, "[s]uch an intention must be expressly declared by the legislature or necessarily implied in the language of the statute." *LaCourse v. Fleitz*, 28 Ohio St. 3d 209, 212 (1986). This argument is specious. Section 1.63 is, without question, an express preemption provision. Applying it to the City's claim does not require any "presumption" regarding the statute's preemptive intent; it is plainly expressed in the text.

[5] Thus, contrary to the City's contention, it makes no difference that its suit only seeks to recover monetary damages.

> regulatory power. As the court explained, "[s]tate power may be exercised as much by a jury's application of a state rule of law in a civil suit," as by regulation or ordinance.

City of Philadelphia v. Beretta U.S.A. Corp., 126 F. Supp. 2d 882, 889 (E.D. Pa. 2000) (quoting *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 572 n.17 (1996) and citing *Geier v. Am. Honda Motor Co.*, 529 U.S. 1913 (2000); *Int'l Paper Co. v. Ouellette*, 479 U.S. 481, 495 (1987); *New York Times v. Sullivan*, 376 U.S. 254, 265 (1964)). The Ohio General Assembly broadly defined the scope of municipal action preempted by § 1.63 to include "other action," not just municipal legislation or regulation. Given the expansive wording of the statute and the powerful regulatory potential of common law damage claims, the Court finds that § 1.63 includes common law public nuisance claims like the one asserted by the City. *See City of Philadelphia*, 126 F. Supp. 2d at 889-90 (state statute specifying that power to regulate firearms in Pennsylvania rested exclusively with state legislature preempted common law public nuisance action brought by city against gun industry); *see also Sturm, Ruger & Co. v. City of Atlanta*, 560 S.E.2d 525, 530 (Ga. Ct. App. 2002); *Penelas v. Arms Tech., Inc.*, 778 So.2d 1042, 1045 (Fla. Ct. App. 2001).

The City's citations to a definition contained in another (wholly irrelevant) section of the Ohio Revised Code (§ 4905.65), which by its own terms applies only to "local regulation," does not inform the Court's judgment, as that definition ignores the broad language employed in the statutory text and describes only a small subset of the types of conduct subject to § 1.63. Nor does the City's suggestion that its lawsuit does not qualify as regulation because it does not establish "a detailed, comprehensive, independent code of lender conduct" hold any merit. That the City attempts to paint with a broad brush, attacking all subprime lending within its borders, rather than challenging specific practices or transactions, does nothing to lessen the regulatory nature of its complaint. Regulation can be general or specific, and as Defendants correctly point out, a general enactment barring subprime lending would be no less regulatory than a detailed, comprehensive scheme. Under the circumstances presented, the Court finds that the City's public nuisance action is a regulatory action by a municipal corporation.

Having concluded that the City's complaint constitutes a form of municipal regulatory "action" within the meaning of § 1.63, little doubt remains that the SAC seeks to "regulate, directly or indirectly, the origination, granting, servicing, or collection of loans or other forms of credit[.]" Through its complaint, the City seeks a judicial determination that the alleged subprime mortgage lending and securitization that took place in Cleveland constitutes a public nuisance under Ohio common law. (SAC ¶¶ 4, 8, 21.) Such a finding would label as illegal a broad array of lending practices, including much of the mortgage lending that prevailed in the Cleveland market, which is home to many low income borrowers who did not qualify for prime mortgages. As a result, the SAC represents, at the very least, an indirect attempt to regulate the origination and granting of mortgage loans. It is therefore preempted by Ohio Revised Code § 1.63.

The City cannot avoid preemption simply by claiming it is acting as a private litigant exercising its proprietary powers, rather than performing its governmental function. The statute at issue makes no distinction between actions that regulate in a "governmental" capacity versus a "proprietary" capacity. It simply applies to "action" that "regulate[s]" the specified activities. Ohio Rev. Code § 1.63. As other courts have recognized, "the judicial process can be viewed as the extension of a government's regulatory power." *City of Philadelphia*, 126 F. Supp. 2d at 889. A municipality like the City "may not do indirectly" through litigation "that which it cannot do directly" through legislation. *City of Atlanta*, 560 S.E.2d at 530. Section 1.63 bars the City's lawsuit, just as it would any attempt to legislate on these issues. The distinction the City seeks to draw between its governmental and proprietary functions is, as far as the statute is concerned, one without a difference.

Furthermore, even if the statute acknowledged such a distinction, the very nature of the City's claim – which seeks relief for an alleged *public* nuisance – betrays any contention that its lawsuit is aimed at vindicating the City's private interests rather than "protecting its citizens or pursuing some other civic agenda." (Pl.'s Opp'n to Defs.' Mot. to Dismiss[6] at 28.) Public nuisance is defined as "an unreasonable interference with a right common to the general public." *Brown v. Scioto County Bd. of Comm'rs*, 87 Ohio App. 3d 704, 712 (4th Dist. 1993) (citing Restatement (Second) of Torts § 821B(1) (1979)). Unless the City is pursuing this lawsuit to vindicate "a right common to the general public," i.e., unless it is acting on behalf of the public in a governmental capacity (and not in its own private interest), it necessarily has no claim at all. That this is, in fact, the City's true purpose is on display throughout both the SAC and the City's opposition brief. It seeks to recover damages in the form of municipal expenditures it claims were necessary due to the increased need for police and fire protection and demolition of the foreclosed and vacant homes. (SAC ¶ 64.) Obviously, the City incurred those expenses to protect the public from the hazards posed by the increasing stock of vacant homes, not for some private reason unrelated to the public interest. Similarly, in its opposition the City claims that it is exercising its powers of local self-government (rather than its police power), which it concedes includes "the functions of government [. . .] that [. . .] relate to the municipal affairs of the particular municipality." (Pl.'s Opp'n at 31) (quoting *Fitzgerald v. City of Cleveland*, 88 Ohio St. 338, 344 (1913)). Elsewhere in its opposition, moreover, (in arguing against application of the economic loss rule) the City contends that public nuisance law provides redress for impairment to a public right, which "either inflicts material 'annoyance, inconvenience, or injury' upon the public or creates 'an unreasonable risk of harm.'" (Pl.'s Opp'n at 34) (citations omitted). The City also contends that "[t]he foreclosures precipitated by the Defendants have markedly compromised the 'public health, safety, [and] peace' of life in Cleveland." (Pl.'s Opp'n at 15) (citation omitted).

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[6] Hereinafter abbreviated as "Pl.'s Opp'n."

By asserting a claim for public nuisance, the City by definition seeks to advance its governmental interest in protecting its citizens, rather than some purely private agenda (which it could not, in any event, use a public nuisance claim to pursue).[7] The allegations levied in support of its claim, along with the arguments it raises in opposition to dismissal, confirm the purpose of the City's suit as a means of protecting the public interest.[8] As such it is a regulatory action by a municipal corporation that Ohio Revised Code § 1.63 preempts.

Finally, Defendants' state law preemption argument rests on express statutory grounds and does not implicate the Ohio Constitution. Thus, the City's insistence that its lawsuit does not violate the Home Rule Amendment is of no moment.

For the reasons explained *supra*, the City's public nuisance lawsuit falls within the ambit of the preemption provision of Ohio Revised Code § 1.63, and is therefore subject to dismissal. Even if not preempted by state law, however, the City's claim fails as a matter of law on several other grounds. The Court turns to the substance of the public nuisance claim to address these additional bases for dismissal.

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[7] The City's citation to *City of Vista v. Robert Thomas Secs., Inc.*, 84 Cal. App. 4th 882 (2000) is completely inapposite. In that case, the plaintiff municipality purchased securities directly from the defendant broker. The municipality did not assert a claim for public nuisance, but sought relief on a variety of theories that any private investor would have had standing to pursue. The case bears no factual or legal resemblance to the City's complaint.

[8] If that is not its purpose, and the City is not suing to redress an interference with a right common to the general public, then the SAC clearly fails to state a public nuisance claim as a matter of law. *See Brown*, 87 Ohio App. 3d at 712.

D. Public Nuisance

Ohio law defines nuisance as "a distinct civil wrong, consisting of anything wrongfully done or permitted which interferes with or annoys another in the enjoyment of his legal rights." *Taylor v. City of Cincinnati*, 143 Ohio St. 426, 436 (1944). Nuisances fall into two broad categories, public and private. The City's claim alleges a public nuisance, which is "an unreasonable interference with a right common to the general public." *Brown*, 87 Ohio App. 3d at 712.

Public nuisance divides further into two subcategories – absolute nuisance and qualified nuisance. *Hurier v. Ohio Dep't of Transp.*, No. 01AP-1362, 2002 WL 2005755, at *2 (Ohio App. 10th Dist. Sept. 3, 2002). Absolute nuisance involves conduct that is "inherently injurious," and is essentially a strict liability cause of action. *Brown*, 87 Ohio App. 3d at 713. In contrast, qualified nuisance imposes liability for otherwise lawful actions "so negligently or carelessly done as to create a potential and unreasonable risk of harm, which in due course results in injury to another." *Metzger v. Pa., Ohio, & Detroit R.R. Co.*, 146 Ohio St. 406 (1946) (citing *Taylor*, 143 Ohio St. at 427). "[A] civil action based upon the maintenance of a qualified nuisance is essentially an action in tort for the negligent maintenance of a condition, which, of itself, creates an unreasonable risk of harm, ultimately resulting in injury. The dangerous condition constitute[s] the nuisance. The action for damages is predicated upon carelessly or negligently allowing such condition to exist." *Rothfuss v. Hamilton Masonic Temple Co. of Hamilton*, 34 Ohio St. 2d 176, 180 (1973). Because it is premised upon negligence, a qualified nuisance claimant must plead and prove the traditional elements thereof: duty, breach, proximate causation, and damages. *Allen Freight Lines, Inc. v. Consol. Rail Corp.*, 64 Ohio St. 3d 274, 276 (1992); *Brown*, 87 Ohio App. 3d at 713.

Thus, to state a viable claim for qualified public nuisance, Plaintiff must allege facts sufficient to demonstrate that Defendants owed Plaintiff a duty, Defendants breached that duty, and Defendants' breach proximately caused Plaintiff's injury. *Rahman v. Ohio Dep't of Transp.*, No. 05AP-436, 2006 WL 1645021, at *5 (Ohio App. 10th Dist. June 15, 2006). In a qualified nuisance action like this one, "[t]he allegations of nuisance and negligence [. . .] merge, as the nuisance claims rely upon a finding of negligence." *Allen Freight*, 64 Ohio St. 3d at 276. The presence of a duty equates with the existence of a right common to the general public, and the element of breach is established by reference to an "unreasonable interference" with that public right. The plaintiff also must allege a "special injury," a "particular harm [. . .] that is of a different kind than that suffered by the public in general." *Brown*, 87 Ohio App. 3d at 714. The special injury "must be different in kind, rather than different in degree, from that suffered by other members of the public exercising the public right." *Kramer v. Angel's Path, L.L.C.*, 174 Ohio App. 3d 359, 367 (Ohio App. 6th Dist. 2007) (citing *Miller v. City of W. Carrollton*, 91 Ohio App. 3d 291, 295-96 (2d Dist. 1993)).

1. The Economic Loss Doctrine Bars The City's Claim

Defendants argue that the City's claim is completely barred by the economic loss doctrine which, as a general matter, precludes recovery in tort for purely economic losses not arising from tangible physical harm to persons or property. *See Queen City Terminals, Inc. v. Gen. Am. Transp. Corp.*, 73 Ohio St. 3d 609, 615 (1995) (citing *Floor Craft Floor Covering, Inc. v. Parma Cmty. Gen. Hosp. Ass'n*, 54 Ohio St. 3d 1, 3 (1990)); *Corporex Dev. & Constr. Mgmt., Inc. v. Shook, Inc.*, 106 Ohio St. 3d 412, 414 (2005). The doctrine embodies the well-established principle "that a plaintiff who has suffered only economic loss due to another's negligence has not been injured in a manner which is legally cognizable or compensable." *Floor Craft*, 54 Ohio St. 3d at 3 (internal quotation marks and citations omitted); *see also Chemtrol Adhesives, Inc. v. Am. Mfrs. Mut. Ins. Co.*, 42 Ohio St. 3d 40, 44 (1989).

Defendants argue that the economic loss rule applies in qualified public nuisance actions like this one, and bars the City from its desired recovery. In support of this argument, Defendants cite two cases: *Ashtabula River Corp. Group II v. Conrail Inc.*, 549 F. Supp. 2d 981, 987-88 (N.D. Ohio 2008) and *RWP, Inc. v. Fabrizi Trucking & Paving Co., Inc.*, No. 87382, 2006 WL 2777159, at *3 (Ohio App. 8th Dist. Sept. 28, 2006). The courts in both *Ashtabula River* and *RWP* held that the economic loss doctrine applied to public nuisance actions brought under Ohio law, mandating dismissal of public nuisance claims seeking only economic damages.

Looking to avoid the fatal effect of the economic loss doctrine, the City makes several arguments, none of which has merit. First, the City baldly asserts that Ohio courts "do[] not enforce the economic loss rule in public nuisance cases." (Pl.'s Opp'n at 34-35.) This statement is at best misleading, as the City provides absolutely no direct support for it. The *Ashtabula River* and *RWP* decisions are the only Ohio cases discussing the application of the economic loss doctrine to public nuisance claims, and both concluded that the rule applies. Thus, the City's contention that Ohio courts do not apply the economic loss doctrine in public nuisance cases is palpably false, and its direct converse is true. The City's real argument is that both *Ashtabula River* and *RWP* were wrongly decided and can and should be ignored.

The City supports this position by (1) citing two law review articles suggesting that the economic loss doctrine should not apply in public nuisance actions; (2) arguing that the courts in *Ashtabula River* and *RWP* erred by failing to follow the Restatement (Second) of Torts on the issue; and (3) claiming that the Ohio Supreme Court implicitly acknowledged the inapplicability of the economic loss doctrine in *City of Cincinnati v. Beretta USA Corp.*, 95 Ohio St. 3d 416 (2002) (hereinafter, "*City of Cincinnati*"). These arguments are addressed *seriatim*.

Without citing any Ohio cases, the City instead refers to two law review articles, Denise E. Antolini, *Modernizing Public Nuisance: Solving the Paradox of the Special Injury Rule*, 28 Ecology L.Q. 755, 824 (2001), and David Kairys, *The Governmental Handgun Cases and the Elements and Underlying Policies of Public Nuisance Law*, 32 Conn. L. Rev. 1175, 1186 (2000), both of which suggest that public nuisance claims are excepted from the economic loss rule.[9] As Defendants point out, these articles predate the *Ashtabula River* and *RWP* decisions and make no attempt to address the specifics of Ohio law. The articles therefore hold correspondingly little persuasive value in terms of describing Ohio law as it exists today. This is particularly so in light of the Ohio Supreme Court's recent reiteration of its commitment to the economic loss doctrine. In 2005, it observed that:

> The economic-loss rule generally prevents recovery in tort of damages for purely economic loss. The well-established general rule is that a plaintiff who has suffered only economic loss due to another's negligence has not been injured in a manner which is legally cognizable or

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[9] The Kairys article devotes a single sentence to the economic loss issue, stating that the "economic loss doctrine [. . .] could not be applied to public nuisance claims without overruling at least two centuries of public nuisance law." Kairys, *supra*, at 1185. But while the author casts this statement of law in confident, seemingly incontrovertible language, it is supported with a single citation to a federal district court opinion, *In re One Meridian Plaza Fire Litig.*, 820 F. Supp. 1460, 1480 (E.D. Pa.), *rev'd on other grounds*, 12 F.3d 1270 (3d Cir. 1993). The court in *One Meridian Plaza* summarily concluded that "it is clear that the economic loss doctrine is not applicable to public nuisance claims [. . .]." 820 F. Supp. at 1480. However, at least one Pennsylvania court subsequently refused to follow the *One Meridian Plaza* decision on this very point and instead concluded that the Pennsylvania Supreme Court would adhere to "Pennsylvania's strong, oft-stated public policy of barring recovery for economic losses sustained as a result of another's tortious conduct [. . .]." *Duquesne Light Co. v. Pa. Am. Water Co.*, 850 A.2d 701, 704 (Pa. Super. 2004) (affirming summary judgment in favor of defendant in public nuisance action based upon economic loss doctrine). Like Pennsylvania, Ohio has a "strong, oft-stated" commitment to the economic loss doctrine.

> compensable. This rule stems from the recognition of a balance between tort law, designed to redress losses suffered by breach of a duty imposed by law to protect societal interests, and contract law, which holds that parties to a commercial transaction should remain free to govern their own affairs. Tort law is not designed to compensate parties for losses suffered as a result of a breach of duties assumed only by agreement. That type of compensation necessitates an analysis of the damages which were within the contemplation of the parties when framing their agreement. It remains the particular province of the law of contracts.

Corporex, 106 Ohio St. 3d at 414 (internal quotation marks and citations omitted).

The City further contends that the courts in *Ashtabula River* and *RWP* erroneously failed to rely upon two illustrations set forth in a comment to the Restatement (Second) of Torts. *See* RESTATEMENT (SECOND) OF TORTS § 821C cmt. h (1979). This argument is without merit. The City's assertion that "Ohio courts rely heavily on [the Restatement] in delineating the contours of public nuisance law" is, at least with respect to the illustrations it cites, a serious exaggeration. A search of Ohio cases discloses exactly one published decision that makes any reference to Section 821C of the Restatement.[10] *See Brown*, 87 Ohio

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[10] There are two unpublished decisions as well, but they simply cite the published decision and note its reliance upon Section 821C. *See Hager v. Waste Techs. Indus.*, No. 2000-CO-45, 2002 WL

App. 3d at 714. That case refers directly to the text of the Restatement itself, and it does so in support of an uncontroversial proposition unrelated to the City's argument. *Id*. The City does not cite, and the Court is not aware of, any Ohio case relying upon any of the comments to Section 821C or upon any of the eleven illustrations contained therein. The City's suggestion that *Ashtabula River* and *RWP* were wrongly decided because those courts failed to defer to certain illustrations buried in the commentary section of a treatise is completely unfounded. Unlike the authors of the illustrations in the Restatement, the courts in *Ashtabula River* and *RWP* were bound to apply the law of Ohio as explained in the decisions of the State's highest court. In doing so, they concluded that the economic loss doctrine applies in public nuisance actions. The Restatement illustrations the City believes should trump those rulings run afoul of the economic loss doctrine and make no pretense of accounting for it. Thus, it certainly cannot be said that the courts in *Ashtabula River* and *RWP* erred by failing to heed the illustrations cited by the City; indeed, it would have been error to refuse to apply binding precedents on the basis of such authority.

Likewise, the Court is not persuaded by the City's argument that the Ohio Supreme Court's decision in *City of Cincinnati* supports a finding that the economic loss doctrine does not apply in public nuisance cases. The court in *City of Cincinnati* did not confront the economic loss doctrine in its discussion of the public

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1483913, at *9 (Ohio App. 7th Dist. June 27, 2002); *Uland v. S.E. Johnson Cos.*, No. WM-97-005, 1998 WL 123086, at *5 (Ohio App. 6th Dist. Mar. 13, 1998).

nuisance claim. It simply was not addressed.[11] While the City suggests that this fact is sufficient to indicate that the Ohio Supreme Court would not apply the economic loss doctrine if actually confronted with the issue, the Court disagrees. Viewed most charitably to the City's position, the Ohio Supreme Court's silence on the issue at best gives rise to a weak implication that it would not apply the economic loss doctrine in public nuisance actions. That implication might hold some persuasive value in the absence of any reliable indicators of how Ohio courts would decide this issue and if courts in other jurisdictions supported that view. But this is not an issue of first impression. Two previous Ohio cases (both decided after *City of Cincinnati*) placed the question of whether the economic loss doctrine applies in public nuisance cases squarely at issue, and both times, following thorough discussions of the applicable law, the courts answered in the affirmative. *Ashtabula River*, 549 F. Supp. 2d at 987-88; *RWP*, 2006 WL 2777159, at *4. Similarly, in Illinois, a jurisdiction which (like Ohio) abides by the economic loss rule, that state's highest court concluded that the rule barred recovery of purely economic damages in public nuisance actions. *City of Chicago v. Beretta U.S.A. Corp.*, 213 Ill. 2d 351, 420 (2004). To follow the City's invitation and reject these well-reasoned decisions on the basis of a heretofore unrecognized, purported *sub silentio* holding would be an exercise in judicial recklessness, if not pure folly.

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[11] The City argues that because the court affirmed dismissal of Cincinnati's statutory product liability claims under the Ohio Products Liability Act ("OPLA") on grounds that the plaintiff failed to allege "harm" within the meaning of Ohio Rev. Code § 2307.79, the court implicitly held that the economic loss rule did not apply to the public nuisance claim, or else it would have dismissed the claim on that basis. To recover under the OPLA, the plaintiff must allege "harm," which is defined as "death, physical injury to person, serious emotional distress, or physical damage to property other than the product in question. Economic loss is not 'harm.'" Ohio Rev. Code § 2307.71(G). This definition sounds a lot like the economic loss rule, but the fact that the court in *City of Cincinnati* affirmed dismissal of the statutory claims based upon the plaintiff's failure to satisfy the terms of the statute is not the same as saying it dismissed the claims based upon the economic loss rule. The OPLA is a statutory scheme enacted by the Ohio General Assembly which governs strict product liability claims in Ohio. *E.g., Botnick v. Zimmer, Inc.*, 484 F. Supp. 2d 715, 722 (N.D. Ohio 2007). By contrast, the economic loss doctrine is a creature of negligence law. The conclusion in *City of Cincinnati* that the plaintiff failed to allege "harm" within the meaning of the statutory definition provided by the OPLA does nothing to convince this Court that in doing so, without any discussion whatsoever, the Ohio Supreme Court also intended to implicitly repudiate the economic loss doctrine in qualified public nuisance cases dependent upon a finding of negligence, especially in light of the Ohio Supreme Court's more recent decision in *Corporex*.

For these reasons, while the Court concurs with the City's assessment that *Ashtabula River* and *RWP* are not binding precedents, the Court finds the City's case for ignoring them completely unpersuasive. Accordingly, the Court rejects the City's suggestion that the cases were wrongly decided and do not accurately set forth the law of Ohio, but instead finds *Ashtabula River* and *RWP* compelling and agrees with Defendants that the economic loss doctrine prevents recovery of purely economic losses in a public nuisance action.

Finally, the City suggests that even if the economic loss rule applies to public nuisance suits, its complaint does not contravene the rule because the damages it seeks to recover are not exclusively economic, but are (at least partially) related to property damage.

Specifically, the City alleges that Defendants' conduct caused physical degradation of the foreclosed homes, turning them into "eyesores," and "fire hazards," leading the City to incur "maintenance and demolition costs, together with increased fire and safety expenditures, while losing tax revenues on account of the diminished value of both the foreclosed residences and its [sic] neighbors." (Pl.'s Opp'n, at 38.)

In the SAC, the City asserts two general categories of damages, one consisting of the diminished property tax receipts owing to the foreclosure crisis, the other its costs in maintaining and demolishing the blighted post-foreclosure properties. As to the former category, there can be little dispute that these damages are purely economic in nature. *See Pavlovich v. Nat'l City Bank*, 435 F.3d 560, 569 (6th Cir. 2006) (citing *Chemtrol*, 537 N.E.2d at 629) ("Economic losses include [. . .] diminution in value and consequential losses like lost profits"). With respect to the latter category, while the physical deterioration of foreclosed homes may represent an injury to property sufficient in the abstract to avoid the economic loss rule, the affected properties did not belong to the City when the physical damage allegedly took place. Instead, the City seeks to recover for alleged physical damage to properties it did not own, but that were owned by someone else – i.e., the homeowners that went through foreclosure. The City provides no support for this position, and none exists.

As explained previously, the economic loss rule precludes tort recovery for economic losses not arising from tangible physical harm to persons or property. *Corporex*, 106 Ohio St. 3d at 414; *Floor Craft*, 54 Ohio St. 3d at 3. Thus, it does not bar a plaintiff from recovering economic damages that occurred as a result of damage *to the plaintiff's property*, *see Queen City Terminals*, 73 Ohio St. 3d at 615, but it cannot be avoided by claiming that physical damage occurred to the property of someone else. The court in *RWP* confronted and rejected the very same argument the City advances here. In that case, the plaintiffs subscribed to telecommunications services provided by SBC Ameritech. *RWP*, 2007 WL 2777159, at *1. The defendant cut the cables owned by SBC Ameritech, causing a service outage lasting several days that affected thousands of SBC Ameritech's customers, including the plaintiffs. *Id.* The plaintiffs sued the defendant on a public nuisance theory, the trial court granted summary judgment in favor of the defendant based upon the economic loss rule, and the Eighth District Court of Appeals affirmed. On appeal, the plaintiffs argued that the economic loss rule did not apply because, *inter alia*, they had sustained tangible property damage. *Id.* at *2. The court rejected this argument, concluding that the plaintiffs "ha[d] no property interest in the cables that were cut [. . .]" and "therefore failed to establish that they suffered harm to their persons or their property as a result of the outages." *Id.* at *4. Here, the City does not contend that it had any recognizable property interest in the (unidentified) properties that were allegedly damaged when they went through foreclosure. The City has thus failed to allege any injury to persons or property in which it had an interest, and the damages it seeks to recover are purely economic. As a consequence, its claim is barred by the economic loss doctrine.

2. The City's Allegations Do Not Establish Unreasonable Interference With A Public Right

Notoriously vague and ill-defined, public nuisance claims have been used to impose liability for a broad panoply of conduct. *See* RESTATEMENT (SECOND) OF TORTS § 821B cmt. a (1979) (examples include double parking; hitting golf balls into highways; keeping diseased animals; practicing medicine without a license; handling a snake at a religious ceremony; conducting a bullfight; using fireworks in the street; operating a noisy, rowdy dance hall; and playing baseball on Sundays). The nebulous and malleable nature of the claim notwithstanding, Ohio courts have long imposed the following concrete limitation on public nuisance claims: "What the law sanctions cannot be held to be a public nuisance." *Allen Freight*, 64 Ohio St. 3d at 277 (quoting *City of Mingo Junction v. Sheline*, 130 Ohio St. 34 (1935) and citing *Toledo Disposal Co. v. State*, 89 Ohio St. 230 (1914), *Francis v. Barberton*, 28 Ohio Law Abs. 359 (Ohio App. 9th Dist. 1938)).

> This is but another way of saying that although it would be a nuisance at common law, conduct which is fully authorized by statute or administrative regulation is not an actionable tort. This is especially true where a comprehensive set of legislative acts or administrative regulations governing the details of a particular kind of conduct exist.

Brown, 87 Ohio App. 3d at 713.

Here, Defendants claim that their conduct cannot constitute a public nuisance because the subprime lending that underlies the City's claim was permitted, and even encouraged, by government regulation. According to Defendants, if subprime lending was sanctioned by law – and the City does not contend otherwise – then it cannot constitute a public nuisance under Ohio law. Therefore, the City's allegations against Defendants – accusing them of providing funding for subprime loans – cannot possibly be classified as a public nuisance.

The City responds by arguing that otherwise lawful conduct can still constitute a public nuisance if performed negligently. The City also contends that the regulations Defendants rely upon were inadequate and "reflect[] a total vacuum of effective oversight." (Pl.'s Opp'n at 19.) Furthermore, the City maintains, the regulations cited by Defendants pertain to lending, while the City challenges their mortgage securitization activities.

As to the first point of contention, this presents a purely legal question – does Ohio law allow otherwise legally-sanctioned conduct that is negligently performed to be classed as a public nuisance? The City says yes, Defendants say no. Defendants have the better argument. The City's position fails to frame the issue properly because it ignores the difference between conduct that is merely "lawful," as in "not legally prohibited," and conduct that is subject to regulation and, within the framework of a regulatory scheme, encouraged. Some illustrations are instructive.

It is, without question, perfectly lawful to own a trash receptacle and place it on one's property. As a general matter, no set of comprehensive state or federal statutes or regulations governs the placement of trash receptacles on property. Thus, such conduct is generally lawful, but not regulated. In a public nuisance action based upon such conduct, the plaintiff must plead and prove negligence. For instance, in *Williams v. 312 Walnut Ltd. P'Ship*, No. C-960368, 1996 WL 741982 (Ohio App. 1st Dist. Dec. 31, 1996), the plaintiff was walking on a skywalk when he encountered a trash receptacle and, instead of walking around it, attempted to vault over it, but failed and fell to the street below, sustaining severe injuries that ultimately led to his death. *Williams*, 1996 WL 741982, at *1. The plaintiff sued the owners of the property alleging, *inter alia*, that the trash receptacle "constituted a public nuisance which made the usual and ordinary course of travel on the skywalk unsafe [. . .]." *Id.* at *6. The court evaluated the claim using traditional negligence principles, ultimately concluding that the property owners did not breach a duty to warn the plaintiff of an open and obvious danger relative to the trash receptacle. *Id.* But the fact that the law generally allows the ownership and use of trash receptacles did not immunize any of the defendants from liability.

The analysis differs where the conduct allegedly constituting a public nuisance is subject to regulation. Where a regulatory scheme governs the conduct of certain activity, courts assess whether the defendant complied with the regulatory scheme to determine whether a duty was breached, i.e., whether the defendant unreasonably interfered with a public right. Under such circumstances, if the defendant complies with that scheme, he cannot be sued for public nuisance by a plaintiff claiming that, despite compliance with the regulatory system, the activity was nevertheless performed in a negligent manner.[12] In *Hager*, for instance, the plaintiffs owned property adjacent to land on which the defendant built and operated a hazardous waste storage and treatment facility. 2002 WL 1483913, at *1. The plaintiffs sued the defendant alleging that the waste incinerator created a public nuisance due to the adverse effects it produced on the surrounding water, air, land, and the public's perception of the health and safety of the area. *Id.* The facility was regulated, and the defendant obtained all the necessary state and federal permits. *Id.* Citing evidence presented by the defendant that it was licensed to operate its hazardous waste incineration plant, the court held that "[s]ince [the defendant's] waste incineration facility operate[d] under sanction of law, based on that fact alone, it cannot be a common law public nuisance." *Id.* at *9 (citing *Allen Freight*, 64 Ohio St. 3d at 277) (further citations omitted). Finding that the defendant's conduct complied with the applicable regulatory scheme, inquiry into the common law public nuisance claim was at its end.

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[12] But just because the actor failed to comply with the regulatory scheme does not mean he is liable per se, because violation of a statute imposed for public safety will not preclude assertion of defenses and excuses-or in other words, will not result in strict liability – unless the statute clearly contemplates such a result. *Sikora v. Wenzel*, 88 Ohio St. 3d 493, 496 (2000). Thus, limiting nuisance actions to situations where the defendant has complied with a regulatory scheme does not convert qualified public nuisance into absolute public nuisance.

Because Defendants claim immunity from a public nuisance action based upon compliance with an applicable regulatory structure, this case is akin to *Hager*, and Defendants' view of the law is the correct one. Under a long line of decisions, a showing that the challenged conduct is subject to regulation and was performed in conformance therewith insulates such conduct from suit as a public nuisance. *Allen Freight*, 64 Ohio St. 3d at 277; *Mingo Junction*, 130 Ohio St. at 34. This is so regardless of whether, despite compliance with the regulations, such conduct could otherwise be described as negligent.[13]

This distinction between conduct that is subject to regulation, and conduct that is merely lawful, also highlights a fundamental difference between the instant case and *City of Cincinnati*, on which the City relies heavily for support. In that case, the plaintiff alleged that the defendant gun manufacturers marketed, distributed, and sold firearms in a manner that facilitated widespread accessibility of weapons to prohibited users, including children and criminals. *City of Cincinnati*, 95 Ohio St. 3d at 416. The plaintiff claimed that this conduct created and sustained an illegal underground market for firearms in Cincinnati. *Id.* The gun manufacturers argued that the distribution of firearms was highly regulated and therefore, based upon longstanding precedent indicating that conduct the law sanctions cannot constitute a public nuisance, they could not be held liable. In rejecting this argument, the Ohio Supreme Court distinguished cases like *Mingo Junction*, concluding that "[e]ven though there exists a comprehensive regulatory scheme involving the manufacturing, sales, and distribution of firearms [. . .], the law does not regulate the distribution practices alleged in the complaint." *Id.* at 420. Thus, it was the plaintiff's allegation of an unregulated, illegal firearms market that allowed the public nuisance claim to escape dismissal. The City's SAC offers no analog. There is no contention that subprime lending and mortgage securitization in Cleveland took place in an unregulated environment.

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[13] Obviously, this conclusion is strictly limited to qualified public nuisance actions under Ohio common law. The Court has not considered, and expresses no opinion about, the effect compliance with a set of applicable regulations would have on any other type of claim. Moreover, as noted in *Crawford v. Nat'l Lead Co.*, 784 F. Supp. 439, 445 (S.D. Ohio 1989), "[a]lthough what is authorized by law cannot be a *public* nuisance, it may nevertheless be a *private* nuisance, and the legislative authorization does not affect any claim of a private citizen for damages for any special inconvenience and discomfort caused by the authorized act not experienced by the public at large" (internal quotation marks and citations omitted).

Thus, if the challenged conduct is subject to regulation and the defendant complied with the regulatory structure, that conduct is not actionable under Ohio law as a public nuisance. Defendants assert that subprime lending was so regulated, and the City does not challenge Defendants' compliance with those regulations. Accordingly, Defendants argue, they cannot be held liable for public nuisance. The Court agrees.

Mortgage lending in general is subject to a vast regulatory regime. At the federal level, mortgage lenders are subject to a wide variety of statutes, including the Truth in Lending Act, 15 U.S.C. § 1601 *et seq.*, the Real Estate Settlement Procedures Act, 12 U.S.C. § 2601 *et seq.*, the Home Mortgage Disclosure

Act, 12 U.S.C. § 2801 *et seq.*, the Alternative Mortgage Transaction Parity Act, 12 U.S.C. § 3801, *et seq.*, the Fair Housing Act, 42 U.S.C. § 3601 *et seq.*, and the Equal Credit Opportunity Act, 15 U.S.C. § 1691 *et seq.* The State of Ohio also has numerous laws that apply to mortgage lending, including the Land Installment Contract Act, Ohio Rev. Code § 5313.01 *et seq.*, the Ohio Mortgage Loan Act, Ohio Rev. Code § 1321.51 *et seq.*, and the Ohio Homeowners Equity Protection Act, Ohio Rev. Code § 1349.25 *et seq.*

Of particular relevance to this proceeding, in addition to the statutes noted *supra*, the federal government has enacted numerous laws and issued significant regulatory guidance specifically aimed at encouraging lending to traditionally underserved segments of the population. For instance, Congress enacted the Community Reinvestment Act of 1977, 12 U.S.C. § 2901 *et seq.*, which requires federal agencies "to assess an institution's record of meeting the credit needs of the entire community, including low and moderate income neighborhoods, [. . .] and simultaneously to encourage the institution to do so." *Nat'l State Bank, Elizabeth, N.J., v. Long*, 630 F.2d 981, 984 (3d Cir. 1980) (internal citations omitted).

In addition, Congress created the Federal Home Loan Mortgage Corporation ("Freddie Mac") in 1970, and later wrote its purposes into law as part of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"). 12 U.S.C. § 1451 *et seq.* FIRREA was later amended by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, and those amendments expressed that "[t]he congressional purposes for Freddie Mac are clearly designed to serve the public interest by increasing the availability of mortgages on housing for low- and moderate-income families and by promoting nationwide access to mortgages." *Am. Bankers Mortgage Corp. v. Fed. Home Loan Mortgage Corp.*, 75 F.3d 1401, 1406-07 (9th Cir. 1996). A related goal of the federal legislation creating institutions like Freddie Mac was to "enhanc[e] the availability of capital to lenders through a more sophisticated secondary mortgage market relying in principal part on *mortgage-backed securities* to bridge the gap between the investment community and the residential mortgage market." *Anchor Sav. Bank, FSB v. United States*, 81 Fed. Cl. 1, 16 (2008). Government-sponsored entities ("GSEs") like Freddie Mac "were established to improve the affordability of homes and home finance to lower- and middle-income Americans." *Id.* at 17.

To achieve these objectives, the Department of Housing and Urban Development repeatedly urged the GSEs to increase their role in furthering subprime lending. In 2000, HUD declared that "[a]n expanded GSE presence in the subprime market could be of significant benefit to lower-income families, minorities, and families living in underserved areas." HUD's Regulation of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), 65 Fed. Reg. 65044, 65106 (Oct. 31, 2000). In a later statement, HUD expressed its view that this expansion in subprime lending was working to achieve the desired objective:

> The growth in subprime lending over the last several years has benefited credit-impaired borrowers—those who may have blemishes in

> their credit records, insufficient credit history, or non-traditional credit sources. Subprime lenders have allowed these borrowers to access credit that they could not otherwise obtain in the prime credit market.

HUD's Housing Goals for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) for the Years 2005-2008 and Amendments to HUD's Regulation of Fannie Mae and Freddie Mac, 69 Fed. Reg. 63580, 63647 (Nov. 2, 2004).

The picture that develops from an overview[14] of these laws and agency actions is not just one of significant regulation, but of express governmental encouragement of the type of lending that forms the basis for the City's claim. In light of the vast regulatory machinery described *supra*, the City does not and cannot dispute the fact that subprime mortgage lending, which is absolutely fundamental to the allegations in the SAC, is subject to significant regulation. As such, it is, under Ohio law, conduct "the law sanctions." *Mingo Junction*, 130 Ohio St. at 34. This compels the conclusion that the City's allegations cannot state a viable claim for public nuisance. *Id*.

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[14] The foregoing is by no means intended to provide an exhaustive view of the applicable regulatory universe. For purposes of the issues before the Court, reference to the state and federal laws cited herein is, in the Court's view, more than sufficient to establish that subprime lending was and is subject to significant regulation. Further discussion of the regulatory framework would be superfluous.

The City tries to avoid this conclusion by insisting that the SAC attacks only the securitization activities of Defendants, while simultaneously disclaiming any challenge to the actual subprime lending that occurred in Cleveland. According to the City, securitization, unlike subprime lending, is not regulated, and therefore can constitute a public nuisance (and should be analyzed using general negligence principles). This argument defies logic and is not well-taken.

In the SAC, the City specifically alleges that subprime lending was inappropriate for Cleveland because its population was generally poor and underemployed, its economy was less than robust, and property values in the City were not rising as they were elsewhere. According to the City, these conditions "should have eliminated Cleveland as a market for widespread subprime lending." (Compl. ¶ 59.) Thus, its complaint is that subprime loans should never have been given to borrowers in the City because it was all too foreseeable that these borrowers would ultimately default and the properties would be foreclosed, leaving the City to deal with the fallout. In essence, the City claims that as a whole, its residents were improper candidates for receiving subprime loans because those loans were too risky, and accuses Defendants of ignoring those risks and encouraging subprime lending within the City anyway by creating MBS that included mortgages on Cleveland properties. But even crediting the City's allegation that securitization of subprime mortgages increased demand for such mortgages and created a "money seeking borrowers" phenomenon, the City does not contend (nor would it make any sense to contend) that the fact that subprime loans were packaged into securities and resold heightened the default risk of any particular underlying mortgage.

The fundamental facts on which individual mortgage underwriting decisions were made and the factors affecting the borrower's actual ability to repay (the borrower's income, job stability, savings, etc.) did not vary based on the quantity of subprime loans that were issued. Thus, whether or not Defendants' securitization activities were responsible for increasing the overall number of subprime loans, if the underlying lending activity was lawful, it is impossible to say that supporting that activity by supplying funds and creating MBS – at least one step removed from the actual lending – was itself unlawful. Stated the other way, the City's public nuisance theory cannot succeed against Defendants unless the subprime lending Defendants allegedly facilitated also constituted a public nuisance.

Yet the City does not claim that the underlying subprime mortgage lending was illegal, but instead concedes, as it must, that subprime lending was subject to extensive regulation. Nowhere in the SAC does the City allege that Defendants violated any of the myriad laws governing mortgage lending.[15] This is fatal to the City's claim. There is no question that the subprime lending that occurred in Cleveland was conduct which "the law sanctions," and as such, it cannot be a public nuisance. *Allen Freight*, 64 Ohio St.

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[15] This is, of course, a general statement, but it must be so general precisely because the City is challenging securitization activity generally, not the legality of any specific MBS or of the loan given to any specific borrower. Without question, it is possible that certain individual lenders engaged in specific transactions that did not comply with applicable regulations, but that possibility is not presented by the SAC and has no impact on the issues before the Court.

3d at 277; *Mingo Junction*, 130 Ohio St. at 34. By extension, therefore, facilitating that lawful conduct by financing it cannot be a public nuisance either. Defendants provide a useful analogy by citing *Hager*. If it was not a nuisance to build and operate a waste incinerator because the construction and operations complied with applicable regulations, *Hager*, 2002 WL 1483913, at *11, then any banks that financed the project certainly would not be subject to suit on grounds that doing so created a public nuisance.

The City also argues that even if the general rule exempts regulated conduct from public nuisance actions, that rule should be disregarded in this case because the regulations were ineffective and failed to prevent the calamitous foreclosure situation that befell Cleveland. But as the limiting principle in *Mingo Junction* recognizes, courts are not in the business of second-guessing the wisdom of legislative or regulatory decisions. Indeed, that is the very purpose of the rule – to keep courts out of the process where Congress or the General Assembly has already struck the regulatory balance. The City fails to provide any authority for the proposition that conduct that is subject to and complies with regulation can nevertheless be deemed a public nuisance based upon a judicial finding that the regulatory system was inadequate. Based upon long-established Ohio law, compliance with a regulatory scheme exempts the regulated conduct from constituting a public nuisance. This Court cannot and will not substitute its judgment for that of the regulators whose express responsibility it was to oversee mortgage lending, particularly where some of those same regulators were explicitly encouraging the very conduct of which the City complains. Thus, the City's claim fails as a matter of law.

3. The City's Allegations Are Not Sufficient To Demonstrate That Defendants' Conduct Proximately Caused Its Alleged Damages

Defendants argue that the SAC is defective because the City's allegations fail to satisfy the directness requirement set forth in *Holmes v. Secs. Investor Prot. Corp.,* 503 U.S. 258 (1992). The *Holmes* case discussed the principle of "remoteness," which is related to both the substantive tort element of proximate causation, as well as to the prudential standing requirement. As the Sixth Circuit explained, "[s]tanding poses a threshold question involving constitutional [and] prudential [. . .] limitations on who may sue, regardless of the merits of that person's claim." *Trollinger v. Tyson Foods, Inc.*, 370 F.3d 602, 612 (6th Cir. 2004) (citing *Allen v. Wright*, 468 U.S. 737, 750-51 (1984)). The standing aspect of remoteness focuses on whether the harm alleged is wholly derivative of the harm suffered by a third party. Proximate causation, on the other hand, "poses a merits question involving common-law and prudential limitations on the consequences for which the law will hold a defendant accountable, regardless of the plaintiff's standing to sue." *Trollinger*, 360 F.3d at 612 (citing *Holmes*, 503 U.S. at 268). Defendants' directness argument attacks the merits of the proximate causation theory set forth in the SAC, rather than the City's standing to bring suit. Defendants maintain that the City's allegations do not establish a direct relationship between its harm and Defendants' conduct, with too many independent events and potential intervening causes lying in between. This is properly viewed as a merits issue, not one of standing, as "[i]t would be odd to say that the plaintiff lacks standing because of an intervening cause or because the harm to the plaintiff was not reasonably foreseeable; the plaintiff may lose on the merits as a matter of law for lack of proximate cause, but the injured plaintiff would have the right to file a lawsuit." *Id.*

The City raises several arguments in opposition to Defendants' remoteness challenge. First, the City contends that *Holmes* is inapplicable since it involved RICO claims under federal statutory law, while this case arises under Ohio's common law of public nuisance. Defendants argue that *Holmes* applies to any case in which proximate cause is one of the substantive elements or, at the very least, was incorporated into Ohio public nuisance law in *City of Cincinnati*.

As the Sixth Circuit has explained, "[b]ecause the *Holmes* Court emphasized that the RICO statute incorporates general common law principles of proximate causation, remoteness principles are not limited to cases involving the RICO statute." *Perry v. Am. Tobacco Co., Inc.*, 324 F.3d 845, 850 (6th Cir. 2003) (internal citation omitted) (citing *Serv. Employees Int'l Union Health and Welfare Fund v. Philip Morris, Inc.*, 249 F.3d 1068, 1076 n.6 (D.C. Cir. 2001); *Steamfitters Local Union No. 420 Welfare Fund v. Philip Morris, Inc.*, 171 F.3d 912, 934 (3d Cir. 1999); *United Food and Commercial Workers Union, Employers Health and Welfare Fund v. Philip Morris, Inc.*, 223 F.3d 1271, 1274 n.7 (11th Cir. 2000)). In *Perry*, the plaintiffs, who were individual subscribers to Blue Cross/Blue Shield health insurance, sued various tobacco companies based upon allegations that they were forced to pay increased premiums due to the presence of smokers in the insurance pool. The plaintiffs brought claims under RICO, various Tennessee consumer protection statutes, and Tennessee state law claims for breach of special duty, conspiracy, negligence, fraudulent concealment, and unjust enrichment. *Id.* at 848. The district court dismissed all of the plaintiffs' claims pursuant to Rule 12(b)(6) based upon a failure to allege proximate causation due to remoteness. On appeal, the plaintiffs argued that the district court erred by failing to analyze each of the claims individually, arguing that the state law negligence claims were subject to a different, lower proximate cause standard than the RICO claims. Specifically, the plaintiffs asserted that proximate cause could be established simply by showing that the harm was foreseeable. The Sixth Circuit rejected these contentions and affirmed, reasoning, based upon *Holmes* and its progeny, that "[t]hough foreseeability is an element of the proximate cause analysis, it is distinct from the requirement of a direct injury." *Id.* at 850 (citing *Holmes*, 503 U.S. at 268-69; *Laborers Local 17 Health and Benefit Fund v. Philip Morris*, Inc., 191 F.3d 229, 235 (2d Cir. 1999); *Steamfitters Local Union No. 614 Health and Welfare Fund v. Philip Morris, Inc.*, No. W1999-01061-COA-R9-CV, 2000 WL 1390171, at *4 n.2 (Tenn. Ct. App. Sept. 26, 2000). Thus, the court in *Perry* held that *Holmes* applied to state law negligence claims for which proximate cause was a required element of proof.

Any further question as to applicability of *Holmes* to the instant case is answered by the Ohio Supreme Court's opinion in *City of Cincinnati*. There, the Ohio

Supreme Court applied *Holmes* to the claims asserted by Cincinnati against the various gun manufacturers, which included a cause of action under Ohio's common law of public nuisance. *City of Cincinnati*, 95 Ohio St. 3d at 426-28. Given that the Ohio Supreme Court – the final authority on issues of state substantive law – applied *Holmes* to public nuisance claims, and that, as in *Perry*, a negligence standard governs the City's claim, the Court concludes that *Holmes* controls the proximate cause analysis.

The City's next argument against *Holmes* is that issues of proximate cause cannot be resolved on the pleadings. This too is incorrect, as the United States Supreme Court has expressly approved of applying *Holmes* in resolving a motion to dismiss under Rule 12(b)(6). *Anza v. Ideal Steel Supply Co.*, 547 U.S. 451, 453 (2006); *see also Perry*, 324 F.3d at 851 (affirming Rule 12(b)(6) dismissal of complaint, including state law negligence claims, on remoteness grounds); *Ass'n of Wash. Public Hosp. Dists. v. Philip Morris, Inc.*, 241 F.3d 696, 707 (9th Cir. 2001) (common law public nuisance claims under state law properly dismissed on Rule 12(b)(6) motion for lack of proximate cause due to remoteness).

Finding *Holmes* applicable, the discussion turns to the substance of the *Holmes* analysis which, at its core, requires "some direct relationship between the injury asserted and the injurious conduct alleged." *Holmes*, 503 U.S. at 268.

> In *Holmes*, the court explained why directness of relationship is a requirement of causation: (1) indirectness adds to the difficulty in determining which of the plaintiff's damages

> can be attributed to the defendant's misconduct, (2) recognizing the claims of the indirectly injured would complicate the apportionment of damages among plaintiffs to avoid multiple recoveries, and (3) these complications are unwarranted given the availability of other parties who are directly injured and who can remedy the harm without these associated problems.

City of Cincinnati, 95 Ohio St. 3d at 426 (citing *Holmes*, 503 U.S. at 269-70).

Application of *Holmes* dictates the conclusion that the City's claim fails to sufficiently allege proximate cause. The City's allegations fail to demonstrate any direct relationship between its alleged injury and Defendants' conduct. It would be tremendously difficult, if not completely impossible, to determine which of the City's damages are attributable to Defendants' alleged misconduct and not to some absent party. In addition, even if Defendants' securitization activities were somehow unlawful, subprime borrowers and MBS investors stand in closer proximity to Defendants' conduct and have potential claims and remedies available to vindicate their legal rights. Thus, the remoteness concerns articulated in *Holmes* reveal a lack of proximate cause, which mandates dismissal. A factual comparison illustrates.

In *Holmes*, the plaintiff Securities Investor Protection Corporation ("SIPC") was a private non-profit corporation whose members included registered broker-dealers. 503 U.S. at 261. SIPC provided insurance to investors against losses that occurred when one of its members was unable to meet its obligations. When a broker-dealer went bankrupt, SIPC was required to reimburse the broker's clients for claims that remained unsatisfied by the broker's liquidated assets. *Id.* at 261-62. SIPC sued the defendant Holmes, alleging that his conduct in connection with a stock manipulation scheme leading to the bankruptcy of two brokers caused the brokers to be unable to meet their obligations to clients, which, in turn, required SIPC to step in and reimburse the customers. *Id.* at 262-63. SIPC brought its claims under RICO, and the Supreme Court held that its claims were too indirect to permit recovery because the losses were completely contingent upon the insolvency of the third-party brokers that had allegedly occurred as a result of the defendant's actions. *Id.* at 271.

Here, the City's losses are similarly contingent upon the insolvency (or inability or unwillingness to repay) of non-parties – namely, the subprime borrowers whose homes were foreclosed and became fire hazards, eyesores, etc. Indeed, the City's alleged losses in this case are significantly more attenuated than those claimed by the SIPC in *Holmes*. In that case, the challenged conduct was only one step removed from the plaintiff's damages. While Holmes was at best indirectly responsible for SIPC's losses, he was the direct cause of the brokers' insolvency, and the brokers' insolvency directly triggered SIPC's losses. By contrast, Defendants stand atop a lengthy chain of events, far removed from the City's ultimate damages. Defendants allegedly provided funding for MBS, which created significant demand for subprime loans. Mortgage brokers (encouraged by government regulators) went out and found willing borrowers, and with the assistance of lenders, provided mortgages to the subprime borrowers. Defendants then bought up great quantities of these loans, packaged them together in various ways, and quickly resold the MBS to investors. Many of the subprime borrowers later failed to repay their loans. This occurred for any number of reasons. For example, the borrower may have lost a job, kept a job but did not have the wherewithal to repay in the first place, suffered a catastrophic injury, borrowed too much on credit cards, been unable to refinance the original loan, taken out a second mortgage that the borrower was unable to afford, suffered investment losses that depleted savings that were to be used to repay the mortgage, or, despite an ability to pay, simply decided to walk away from the mortgage because the expense was not justified by the property's declining value – all of which the SAC conveniently ignores. Then someone – very importantly, not Defendants – foreclosed on the property. The property then failed to sell at the foreclosure auction and was taken back by the bank or abandoned. Regardless of who owned the property, it was not maintained – again, this could have occurred for any number of reasons. It eventually became an eyesore, a fire hazard, or otherwise deteriorated in condition to such a degree that the City was required to incur costs either maintaining the property or demolishing it. This confluence of events certainly was no small problem given the large volume of foreclosures in Cleveland and the city's budgetary constraints, but under no circumstances can it be described as having been directly caused by Defendants' conduct. As the foregoing discussion illustrates, the potential number of intervening causes borders on incalculable. Accordingly, this case is factually indistinguishable from *Holmes*, directness is lacking, and the SAC must be dismissed.

Examination of the administrative rationales for the directness requirement reinforces this conclusion. As the foregoing factual discussion highlights, Defendants' conduct was at most an indirect cause of the City's claimed damages. As such, the SAC forcefully implicates *Holmes*'s concern with the difficulty of "ascertain[ing] the amount of a plaintiff's damages attributable to the violation, as distinct from other, independent factors[.]" The City even concedes the existence of several independent factors that could lead to foreclosures without regard to Defendants' conduct, including "the City's struggling, Rust-Belt economy, the fading prominence of the manufacturing sector, and Cleveland's challenges in attracting a meaningful replacement." (Compl. ¶ 55.) The City also acknowledges that the foreclosure crisis was precipitated by the broad decline in the housing market, which itself was the product of a myriad of factors occurring in unknown and unknowable proportions, many of which were completely beyond Defendants' control. Sorting out these contributing factors in an effort to assign liability would be a speculation-laden, uncertain endeavor of the exact kind the *Holmes* analysis was designed to avoid. *See Anza*, 547 U.S. at 459; *Laborers Local 17*, 191 F.3d at 239-40; *Canyon County v. Syngenta Seeds, Inc.*, 519 F.3d 969, 983 (9th Cir. 2008).

The directness requirement also advances the notion that "directly injured victims can generally be counted on to vindicate the law as private attorneys general, without any of the problems attendant upon suits by plaintiffs injured more remotely[.]" *Holmes*, 503 U.S. at 269-70. In this case, individual subprime borrowers who lost their homes through foreclosure stand in closer proximity to Defendants' conduct, as do the investors who purchased MBS. As noted previously, mortgage lending is subject to a wide array of regulations. If Defendants participated in any illegal conduct in connection with the underlying subprime lending, individual borrowers have a variety of remedies at their disposal. And unlike the City, MBS purchasers whose investments declined in value have direct relationships with Defendants, and have every reason to pursue any available legal remedies in the event Defendants' conduct failed to conform to the law. "The requirement of a direct causal connection is especially warranted where the immediate victims [. . .] can be expected to vindicate the laws by pursuing their own claims." *Anza*, 547 U.S. at 460. Where, as here, directly injured victims exist and have more "straightforward" legal remedies available to them, "[t]here is no need to broaden the universe of actionable harms to permit [. . .] suits by parties who have been injured only indirectly." *Id.*

In addition, the damages alleged by the City are, as in *Holmes*, purely contingent on harm first visited upon absent third-parties. 503 U.S. at 271. The City seeks to recover costs it incurred in "monitoring, maintaining, and demolishing foreclosed properties" and for "decreased tax revenues resulting from the depreciated value of the affected homes and all surrounding real estate." (Compl. ¶ 70.) Both of these damage categories depend for their existence upon intervening foreclosures suffered by third-party subprime borrowers, not the City. In the absence of the foreclosures (which Defendants did not even directly initiate), the City, by definition, would not have encountered the municipal expenditures it seeks to recover here. Likewise, its theory of lost property tax revenues also depends completely upon the foreclosures. While the foreclosure crisis ultimately wound up driving tax-paying property owners from their homes and depressed the values of neighboring properties, the reduction in value affected the property owners in the first instance, not the City. The City's claimed injury is therefore derivative and, as a consequence, fails as a matter of law for lack of proximate causation.

Finally, any contention by the City that the remoteness analysis in *City of Cincinnati* supports a finding of proximate cause is without merit. In *City of Cincinnati*, the Ohio Supreme Court espoused the *Holmes* analysis consistent with the original pronouncement by the United States Supreme Court, and this Court has applied it here without deviation from that formulation. In addition, as described in detail *supra*, the factual allegations in this case differ markedly and materially from those in *City of Cincinnati*, justifying a different result. As Defendants aptly note, the guns that comprised the illegal firearms market in *City of Cincinnati* originated with the defendant gun manufacturers, while in this case, Defendants did not originate the underlying subprime loans or initiate foreclosures in Cleveland, but merely provided funding for subprime lending. Thus, *City of Cincinnati* might be analogous only if the Ohio Supreme Court had concluded that the banks that provided financing to the gun industry could be held liable on a public nuisance theory. Its opinion does not so much as hint at such a broad expansion of public nuisance law.

This case also differs from *City of Cincinnati* because much of the harm alleged by Cincinnati occurred regardless of any injury to third-parties, while in this case, the City's damages are purely derivative. Cincinnati's damages were related to the existence of an illicit firearms market allegedly fostered by the gun manufacturers' conduct, and included "costs for law enforcement, increased security, prison expenses and youth intervention services." *City of Cincinnati*, 95 Ohio St. 3d at 427. Cincinnati had to bear such costs policing the existence of the market, irrespective of whether third-parties were actually injured by gun violence. As explained *supra*, this case is distinguishable because the City's claim hinges entirely on the foreclosure activity for which Defendants were at best indirectly responsible. The City does not and cannot claim that in the absence of any foreclosures, it was injured by the mere issuance of subprime loans or MBS. Thus, *City of Cincinnati* is of no aid to the City's attempt to fulfill the directness requirement.

Finding the allegations in the SAC insufficient to establish proximate causation, the City's public nuisance claim fails as a matter of law.

III. Conclusion

For the foregoing reasons, Defendants' motions to dismiss are **GRANTED**. The City's public nuisance claim fails as a matter of law because (1) it is preempted by Ohio Revised Code § 1.63; (2) it is barred by the economic loss rule; (3) the City's allegations fail to demonstrate an unreasonable interference with a public right; and (4) the City's allegations are insufficient to demonstrate that Defendants' conduct was the proximate cause of its alleged damages. Accordingly, the SAC is **DISMISSED** with prejudice.

IT IS SO ORDERED.

Dated: May 15, 2009

/s/ Sara Lioi

HONORABLE SARA LIOI
UNITED STATES DISTRICT JUDGE

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

CASE NO. 1:08 cv 139

JUDGE SARA LIOI

[Filed May 15, 2009]

CITY OF CLEVELAND,)
)
Plaintiff,)
)
vs.)
)
AMERIQUEST MORTGAGE)
SECURITIES, INC.; et al.,)
)
Defendants.)
)

JUDGMENT ENTRY

For the reasons stated in the Memorandum Opinion filed contemporaneously with this Judgment Entry, it is hereby **ORDERED, ADJUDGED** and **DECREED** that the Motions to Dismiss filed by defendants Option One Mortgage Corp., Ameriquest Mortgage Securities, Inc., Countrywide Securities Corp., HSBC Securities (USA) Inc., Washington Mutual Bank, and Novastar Mortgage, Inc. (Doc. No. 197); Greenwich Capital Markets, Inc., Morgan Stanley & Co., Inc., Credit Suisse (USA) LLC, Credit Suisse USA, Inc., Goldman Sachs & Co., and Merrill Lynch, Pierce, Fenner & Smith, Inc. (Doc. No. 199);

Wells Fargo Bank, N.A. and Wells Fargo Asset Securities Corporation (Doc. No. 202); Citibank N.A. and Citigroup Global Markets, Inc. (Doc. No. 205); JP Morgan Acquisition Corp., Bear Stearns & Co., Inc., and Chase Bank USA, N.A. (Doc. No. 207); Deutsche Bank Securities, Inc. (Doc. No. 208); Bank of America, N.A. (Doc. No. 209); and GMAC-RFC Holding Company (Doc. No. 228) are **GRANTED**. This case is **DISMISSED with prejudice.**

IT IS SO ORDERED.

Dated: May 15, 2009

/s/ Sara Lioi
HONORABLE SARA LIOI
UNITED STATES DISTRICT JUDGE

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 09-3608

[Filed October 14, 2010]

CITY OF CLEVELAND,

Plaintiff-Appellant,

v.

AMERIQUEST MORTGAGE SECURITIES, INC., ET AL.,

Defendants-Appellees.

O R D E R

BEFORE: SUHRHEINRICH, MCKEAGUE, and GRIFFIN, Circuit Judges.

The court having received a petition for rehearing en banc, which was circulated to all active judges of this court, none of whom requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

ENTERED BY ORDER OF THE COURT

/s/ Leonard Green
Leonard Green, Clerk

APPENDIX D

Fed. R. Civ. P. 12

Rule 12. Defenses and Objections: When and How Presented; Motion for Judgment on the Pleadings; Consolidating Motions; Waiving Defenses; Pretrial Hearing

(a) TIME TO SERVE A RESPONSIVE PLEADING.

(1) *In General*. Unless another time is specified by this rule or a federal statute, the time for serving a responsive pleading is as follows:

(A) A defendant must serve an answer:

(I) within 21 days after being served with the summons and complaint; or

(ii) if it has timely waived service under Rule 4(d), within 60 days after the request for a waiver was sent, or within 90 days after it was sent to the defendant outside any judicial district of the United States.

(B) A party must serve an answer to a counterclaim or crossclaim within 21 days after being served with the pleading that states the counterclaim or crossclaim.

(C) A party must serve a reply to an answer within 21 days after being served with an order to reply, unless the order specifies a different time.

(2) *United States and Its Agencies, Officers, or Employees Sued in an Official Capacity*. The United States, a United States agency, or a

United States officer or employee sued only in an official capacity must serve an answer to a complaint, counterclaim, or crossclaim within 60 days after service on the United States attorney.

(3) *United States Officers or Employees Sued in an Individual Capacity.* A United States officer or employee sued in an individual capacity for an act or omission occurring in connection with duties performed on the United States' behalf must serve an answer to a complaint, counterclaim, or crossclaim within 60 days after service on the officer or employee or service on the United States attorney, whichever is later.

(4) *Effect of a Motion.* Unless the court sets a different time, serving a motion under this rule alters these periods as follows:

(A) if the court denies the motion or postpones its disposition until trial, the responsive pleading must be served within 14 days after notice of the court's action; or

(B) if the court grants a motion for a more definite statement, the responsive pleading must be served within 14 days after the more definite statement is served.

(b) HOW TO PRESENT DEFENSES. Every defense to a claim for relief in any pleading must be asserted in the responsive pleading if one is required. But a party may assert the following defenses by motion:

(1) lack of subject-matter jurisdiction;
(2) lack of personal jurisdiction;
(3) improper venue;
(4) insufficient process;
(5) insufficient service of process;
(6) failure to state a claim upon which relief can be granted; and

(7) failure to join a party under Rule 19.

A motion asserting any of these defenses must be made before pleading if a responsive pleading is allowed. If a pleading sets out a claim for relief that does not require a responsive pleading, an opposing party may assert at trial any defense to that claim. No defense or objection is waived by joining it with one or more other defenses or objections in a responsive pleading or in a motion.

(c) MOTION FOR JUDGMENT ON THE PLEADINGS. After the pleadings are closed — but early enough not to delay trial — a party may move for judgment on the pleadings.

(d) RESULT OF PRESENTING MATTERS OUTSIDE THE PLEADINGS. If, on a motion under Rule 12(b)(6) or 12(c), matters outside the pleadings are presented to and not excluded by the court, the motion must be treated as one for summary judgment under Rule 56. All parties must be given a reasonable opportunity to present all the material that is pertinent to the motion.

(e) MOTION FOR A MORE DEFINITE STATEMENT. A party may move for a more definite statement of a pleading to which a responsive pleading is allowed but which is so vague or ambiguous that the party cannot reasonably prepare a response. The motion must be made before filing a responsive pleading and must point out the defects complained of and the details desired. If the court orders a more definite statement and the order is not obeyed within 14 days after notice of the order or within the time the court sets, the court may strike the pleading or issue any other appropriate order.

(f) MOTION TO STRIKE. The court may strike from a pleading an insufficient defense or any redundant, immaterial, impertinent, or scandalous matter. The court may act:

(1) on its own; or

(2) on motion made by a party either before responding to the pleading or, if a response is not allowed, within 21 days after being served with the pleading.

(g) JOINING MOTIONS.

(1) *Right to Join*. A motion under this rule may be joined with any other motion allowed by this rule.

(2) *Limitation on Further Motions*. Except as provided in Rule 12(h)(2) or (3), a party that makes a motion under this rule must not make another motion under this rule raising a defense or objection that was available to the party but omitted from its earlier motion.

(h) WAIVING AND PRESERVING CERTAIN DEFENSES.

(1) *When Some Are Waived*. A party waives any defense listed in Rule 12(b)(2)-(5) by:

(A) omitting it from a motion in the circumstances described in Rule 12(g)(2); or

(B) failing to either:

(I) make it by motion under this rule; or

(ii) include it in a responsive pleading or in an amendment allowed by Rule 15(a)(1) as a matter of course.

(2) *When to Raise Others*. Failure to state a claim upon which relief can be granted, to join a person required by Rule 19(b), or to state a legal defense to a claim may be raised:

(A) in any pleading allowed or ordered under Rule 7(a);

(B) by a motion under Rule 12(c); or

(C) at trial.

(3) *Lack of Subject-Matter Jurisdiction*. If the court determines at any time that it lacks subject-matter jurisdiction, the court must dismiss the action.

(I) HEARING BEFORE TRIAL. If a party so moves, any defense listed in Rule 12(b)(1)-(7) — whether made in a pleading or by motion — and a motion under Rule 12(c) must be heard and decided before trial unless the court orders a deferral until trial.

(As amended Dec. 27, 1946, eff. Mar. 19, 1948; Jan. 21, 1963, eff. July 1, 1963; Feb. 28, 1966, eff. July 1, 1966; Mar. 2, 1987, eff. Aug. 1, 1987; Apr. 22, 1993, eff. Dec. 1, 1993; Apr. 17, 2000, eff. Dec. 1, 2000; Apr. 30, 2007, eff. Dec. 1, 2007; Mar. 26, 2009, eff. Dec. 1, 2009.)

APPENDIX E

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO EASTERN DIVISION

Case No. 01-cv-139

Judge Lioi

[Filed October 8, 2008]

The City of Cleveland,)
)
Plaintiff,)
)
vs.)
)
Ameriquest Mortgage Securities, Inc.;)
Bank of America, N.A.; Bear Stearns &)
Co., Inc.; Citibank, N.A.; Citigroup Global)
Markets, Inc.; Countrywide Securities)
Corporation; Credit Suisse First Boston)
LLC; Credit Suisse (USA), Inc.; Deutsche)
Bank Securities, Inc; Goldman Sachs & Co.;)
Greenwich Capital Markets, Inc.; HSBC)
Securities (USA), Inc.; JP Morgan)
Acquisition Corp.; Chase Bank U.S.A., N.A.;)
Merrill Lynch, Pierce, Fenner & Smith)
Incorporated; Morgan Stanley & Co., Inc.;)
Novastar Mortgage, Inc.; Option One)
Mortgage Corporation; Washington Mutual)
Bank; Wells Fargo Bank, N.A.; Wells Fargo)

Asset Securities Corporation; and Corporate)
John Does #1 through #10.)
)
Defendants.)
)

SECOND AMENDED COMPLAINT
(Jury Demand Endorsed Hereon)

INTRODUCTION

1. The City of Cleveland sits at the epicenter of a mortgage foreclosure crisis triggered by subprime lenders and the monied interests that support them. Lenders made high-costs loans available by the thousands to unqualified borrowers who had no legitimate chance of keeping up with payments over the long term. A rash of defaults inevitably followed, and the ensuing foreclosures left many homes abandoned and boarded up, transforming them into eyesores, fire hazards, and easy prey for looters and drug dealers in search of a place to conduct their business.

2. This fate has befallen entire streets, blocks, and neighborhoods in Cleveland, displacing both homeowners and tenants of absentee landlords who had acquired their property with subprime loans. Seemingly overnight, the spate of foreclosures vanquished or reversed the successes that had established Cleveland as a national leader in neighborhood revitalization.

3. The epidemic of foreclosures has devalued not only the homes directly affected but surrounding properties as well, deeply depleting Cleveland's tax base. The City has also strained to cover the immediate, tangible costs imposed upon it by the crisis, including increased fire and police expenditures associated with vacant properties, demolition costs, and the like.

4. Subprime lending abuses have inflicted this same kind of damage upon cities across the United States. Cleveland's predicament, however, remains distinctive and unique, and not only because its foreclosure rate surpasses those experienced elsewhere by a substantial margin. The City's economy and housing situation differed significantly from the rest of the country's at the time subprime lending reached its peak. The disparities made mass foreclosures the only possible outcome of flooding the local market with subprime mortgages, even if doing likewise in other cities created no such apparent risk.

5. With respect to Cleveland, the purveyors of subprime mortgages could have and should have foreseen (and in all likelihood actually did foresee) a foreclosure crisis as the inescapable consequence of their conduct. Forced to clean up the resulting mess, the City has sustained hundreds of millions of dollars in damages, in the manner described above.

6. Responsibility for Cleveland's plight rests principally with subprime's so-called "securitizers" – investment banking firms from Wall Street and elsewhere that actually provided the cash used to make loans. The securitizers accomplished this largely by buying the subprime mortgages procured from

borrowers for use as collateral in the formation of new mortgage-backed securities. This type of investment became the darling of Wall Street, given the substantial returns it generated for purchasers.

7. Securitizers typically paid themselves astronomical fees in putting together new offerings of mortgage-backed securities. Their appetite for mortgage-backed securities became so voracious that securitizers explicitly countenanced loans made to borrowers either on financially irrational terms or without any information to corroborate the borrowers' wherewithal to pay – anything to generate new mortgages for the creation of still more mortgage-backed securities.

8. The indiscriminate propagation of subprime loans by securitizers and the corresponding foreclosures constitute a public nuisance under Ohio common law, which entitles the City to recoup the damages it suffered as a result. The City also may recover punitive damages, given the egregiousness of the Defendants' wrongdoing.

JURISDICTION AND VENUE

9. The Court has jurisdiction over this dispute under 28 U.S.C. § 1332 on the basis of diversity of citizenship.

10. Pursuant to 28 U.S.C. § 1391(a), venue properly lies in this district, where a "substantial part of the events ... giving rise to the [City's] claim occurred."

THE CITY OF CLEVELAND

11. With approximately 460,000 residents, Cleveland ranks as the second largest city in Ohio.

12. Between 2002 and 2007, the number of foreclosures effected in the City increased from the low triple digits to more than 7,500.

13. This surge was a distinctly subprime phenomenon. Over the past three years, more than 80 percent of all foreclosures in Cleveland involved subprime mortgages. The subprime foreclosure rate exceeded the rate on conventional loans by more than 800 percent. A full third of the subprime loans made in Cleveland during 2005 have already succumbed to default and foreclosure.

14. The rash of foreclosures has severely depressed the value of Cleveland residences. According to an article in the *Cleveland Plain Dealer*, during the first six months of 2007, the median home sale price in Cleveland dropped by more than 75 percent, from $62,000 to $15,500.

CONNECTION BETWEEN DEFENDANTS AND CLEVELAND FORECLOSURES

15. Based upon information and belief, the City alleges that each of the Defendants played a role in specific subprime foreclosures in Cleveland by participating in the securitization of the underlying mortgage.

THE DEFENDANTS

16. Based in Orange, California, Defendant Ameriquest Mortgage Securities, Inc. was part of the Ameriquest family of companies.

17. Defendant Bank of America, N.A. is a national bank headquartered in Charlotte, North Carolina that engages in the securitization of subprime mortgages.

18. Defendant Bear Stearns & Co., Inc. formerly ranked as one of the nation's preeminent investment banking and securities brokerage firms. The company was headquartered in New York City.

19. Defendant Citibank, N.A. is a national bank headquartered in New York City that securitizes subprime mortgages. Defendant Citigroup Global Markets, Inc. also has its offices in New York City. Both belong to the Citigroup family of companies.

20. Defendant Countrywide Securities Corporation was the securitizing arm of the Countrywide family of companies.

21. Defendants Credit Suisse (USA), Inc. and Credit Suisse First Boston LLC constitute part of the same international financial services conglomerate. Both have headquarters in New York City.

22. Based in New York City, Defendant Deutsche Bank Securities, Inc. underwrote billions in securities backed by subprime mortgages during the period pertinent to this lawsuit.

23. Defendant Goldman Sachs & Co. participates in the securitization process principally as an underwriter. The company has its offices in New York City.

24. Defendant GMAC-RFC Holding Company has its headquarters in Minneapolis, Minnesota. The company engages in the securitization of subprime mortgages.

25. Defendant Greenwich Capital Markets, Inc. has its headquarters in Greenwich, Connecticut and does business as a financial services firm under the name of RBS Greenwich Capital. The company securitizes subprime loans, both in the capacity of underwriter and otherwise.

26. Defendant HSBC Securities (USA), Inc. has underwritten billions in securities backed by subprime mortgages. The company belongs to an international financial conglomerate and has its headquarters in New York City.

27. Defendants JP Morgan Acquisition Corp. and Chase Bank, USA., N.A. are affiliates that each engage in the securitization of subprime mortgages.

28. Defendant Merrill Lynch, Pierce, Fenner & Smith Incorporated has its headquarters in New York City. Merrill Lynch has securitized billions in subprime mortgages, either directly or as an underwriter.

29. Defendant Morgan Stanley & Co., Inc. participates in the securitization process principally as

an underwriter. The company has its offices in New York City.

30. Based in Kansas City, Missouri, Defendant Novastar Mortgage, Inc. has securitized billions of dollars in subprime mortgages.

31. Defendant Option One Mortgage Corporation belongs to the H&R Block family of financial companies. It has its headquarters in Irvine, California.

32. Washington Mutual Bank was formerly a federal savings association based in Seattle, Washington that securitized subprime mortgages.

33. Defendant Wells Fargo Bank, N.A. is a national bank that together with its subsidiary, Defendant Wells Fargo Asset Securities Corporation, engages in the securitization of subprime mortgages.

34. Corporate John Doe Defendants #1 through #10 are affiliates of one or more of the previously named Defendants. Each joined in the securitization of subprime mortgages in Cleveland that culminated in foreclosure.

FACTUAL BACKGROUND

I. Subprime Lending

35. As its name implies, subprime lending involves transactions made at relatively high rates of interest, typically to borrowers with "high credit risk" who do not qualify for conventional loans. Subprime borrowing typically has higher "up-front costs" like application

fees and application fees, as well as higher mortgage insurance rates and more costly late charges and prepayment penalties.

36. Subprime financing became increasingly popular during the 1990s – from 1994 to 2000, subprime lending grew from $35 billion, representing five percent of all originations, to $140 billion, representing 13.4 percent the total. This increase represents an average annual growth rate of 26 percent.

37. The subprime explosion continued into the new millennium. Between 2000 and 2006, the number of subprime loan originations jumped by more than 250 percent, from approximately 911,000 to more than 3.2 million.

II. The Securitization of Subprime Mortgages

38. As indicated above, Wall Street's love affair with mortgage-backed securities largely spurred the unprecedented surge in subprime lending. Mortgage-backed securities comprise a collection of mortgages that originators resell to the issuer of the securities. Investors buy bonds from the issuer, which uses the cash flow generated by the mortgage pools to pay interest and ultimately to return investors' capital.

39. Mortgages undergo a series of transfers involving multiple entities before the issuer acquires them. This separation between the issuer and entity that originated the loans represents the key component to securitization, since without it, the originator could go bankrupt and claim the loans as part of its estate.

40. The essential participants in the securitization of subprime mortgages include

THE ORIGINATOR, which takes and processes the loan application and handles all steps through disbursement of funds to borrowers.

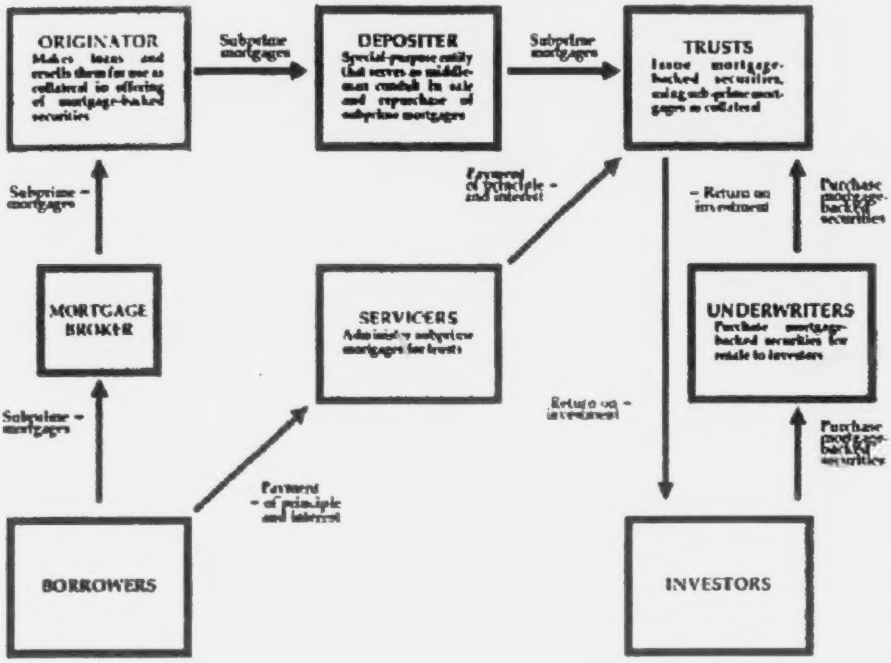
THE MORTGAGE BROKER, which brings prospective borrowers together with prospective lenders (originators);

THE DEPOSITOR, a "special purpose entity" that buys multiple mortgages from originators and pools them together for sale to **TRUST**;

THE TRUST, which buys the mortgages from the **DEPOSITOR** and uses them as collateral in issuing mortgage-backed securities;

THE UNDERWRITERS, which sell the mortgage-backed securities to investors; and

THE SERVICER, which collects payments from borrowers on behalf of **TRUST** and handles other administrative tasks.


ORIGINATOR
Makes loans and resells them for use as collateral in offering of mortgage-backed securities
Subprime mortgages
DEPOSITER
Special-purpose entity that serves as middleman conduit in sale and repurchase of subprime mortgages
Subprime mortgages
TRUSTS
Issue mortgage-backed securities, using sub-prime mortgages as collateral
Subprime mortgages
Payment of principle and interest
Return on investment
Purchase mortgage-backed securities
MORTGAGE BROKER
SERVICERS
Administer subprime mortgages for trusts
UNDERWRITERS
Purchase mortgage-backed securities for resale to investors
Subprime mortgages
Return on investment
Purchase mortgage-backed securities
Payment of principle and interest
BORROWERS
INVESTORS

41. Approximately two-thirds of all mortgage debt in the United States has undergone securitization. A substantial portion of this total comes from government-sponsored entities like the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Federal National Mortgage Association ("Fannie Mae"). Historically, however, Freddie Mac and Fannie Mae deal in "conforming mortgages" that meet certain restricted "borrower quality characteristics and loan-to-value ratios."

42. In contrast, Wall Street has relied upon subprime mortgages to fund their mortgage-backed offerings. These securities offer investors higher rates of return than those backed by "conforming mortgages," since they involve higher rates of interest. They also involve higher degrees of risk, since

subprime borrowers (with their relatively poor credit) default with greater frequency than recipients of loans at prime rate.

III. Wall Street's Preeminence in the Subprime Market

43. Wall Street's involvement in the subprime market encompassed more than just the purchase and pooling of mortgages to back new securities offerings. The investment bankers also provided lenders with lines of credit and other means of financing required to accommodate the dramatic increase in the number of mortgages they were procuring.

44. Securitization eventually became the key source of capital for subprime lenders. The process enabled them to convert mortgages quickly into funds to make new loans. Investment banking firms thus assumed the central role in the cycle of financing that gave rise to the subprime mortgage boom:

> (1) Wall Street made financing available to subprime lenders, which (2) used the cash to make subprime loans to consumers, then (3) sold the related mortgages back to Wall Street, which (4) packaged and resold them to investors in the form of mortgage-backed securities, and (5) used the proceeds to repeat the process.

45. Mortgage-backed securities funded lavish pay days (by even Wall Street standards) for the firms engaged in this business. As indicated above, investment bankers displayed no shyness about the fees they charged in connection with MBS offerings.

Those charges translated into six- and seven-figure bonuses for individual executives responsible for particular clients and deals.

46. The Wall Street firms kept the gravy train rolling by accounting for a substantial portion of the investor demand for mortgage-backed securities. They did so principally through their own proprietary trading programs and through hedge funds that the firms themselves created and managed.

47. Wall Street necessarily held significant influence over subprime lenders, given its concurrent positions as financier, underwriter, and investor in the subprime market. The firms used their preeminent status to set the standard that lenders applied to determine who did (almost everyone) and did not (almost no one) qualify for subprime financing.

IV. The Phenomenon of Money-Seeking-Borrowers

48. In 2003, a fundamental shift took place in how Wall Street constructed their securities offerings backed by subprime mortgages. By that juncture, the demand for this type of investment had grown so significantly that the offerings essentially involved "money seeking borrowers." The firms, in other words, began directing originators on the type of loans to procure in which amounts in order to fill out the pool needed as collateral for each new security.

49. This process subverted the normal operation of the mortgage market and inevitably led to the abandonment of meaningful underwriting standards. Even borrowers unlikely to meet their obligations

would have to receive loans in order for the supply of subprime mortgages to keep pace with Wall Street's burgeoning demand. Lenders devised various new products to bring in the necessary volume of business:

> **Hybrid Adjustable Rate Mortgages**, known as "ARMS," that carried low fixed teaser rates that jumped to much higher adjustable rates after two or three years
>
> **Low- and No-Documentation Loans**, which borrowers could obtain without having to verify their financial resources.
>
> **Interest-Only Loans**, which obligated borrowers to pay interest only for a specified period, when the principal becomes due.

50. Each of these arrangements significantly increased the intrinsically high risk of subprime mortgages, which in all instances match loans with higher-than-average interest rates with borrowers having less-than-average credit.

51. The booming real estate market in the United States principally explained Wall Street's willingness to ignore these fundamental considerations, regardless of the terms that subprime lenders offered to lure new borrowers. Property values in the United States were generally on the rise during the early part of this decade. As a result, the collateral securing new loans was generally appreciating in value – so much so, that default and foreclosure would not necessarily result in a loss.

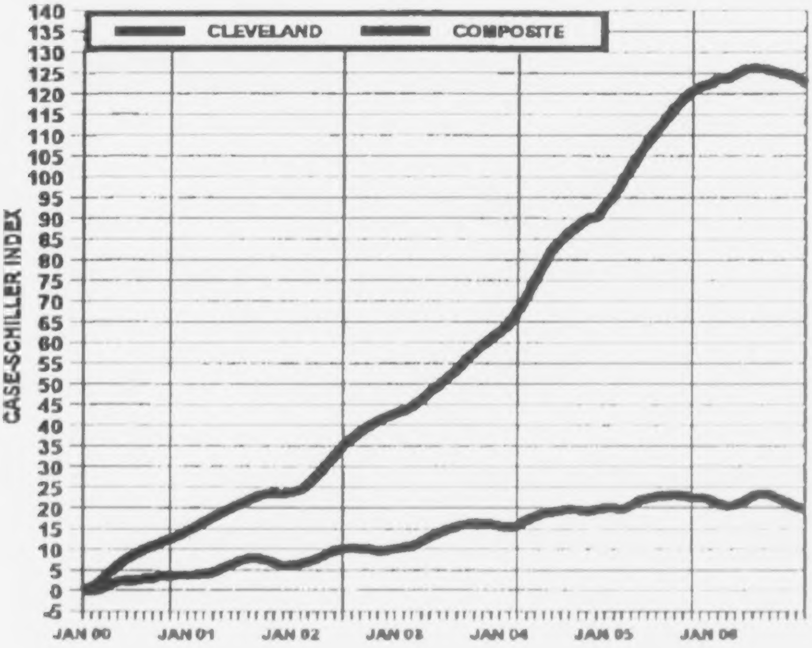
52. Confidence ran so high that Wall Street believed it could turn a blind eye when lenders and brokers originated loans that made no economic sense, either because they involved borrowers with especially poor credit histories or because the amount borrowed far exceeded the current value of the home. These mortgages would ultimately prove good investments for the holder, so long as the housing market held, since the value of the collateral would eventually appreciate well beyond the face value of the loan.

V. **Cleveland's Unique Economic Situation**

53. Whatever merit this hypothesis otherwise seemed to hold, it never had any applicability to the situation in Ohio, or to Cleveland in particular. As illustrated below, property values never appreciated in the City anywhere near the extent to which they did elsewhere. Moreover, the high rate of poverty along with the general sluggishness of the economy and limited employment opportunities both increased the likelihood of defaults on subprime loans and diminished the possibility of attracting new buyers when the rush of foreclosures inevitably hit.

54. For one thing, property values did not skyrocket in the City as they did elsewhere in the nation, as the following graph reflects:

CLEVELAND PROPERTY VALUES vs. NATIONAL AVERAGE



55. Participants in the subprime mortgage industry necessarily would have known about Cleveland's exclusion from the housing bubble. They also would have known about the City's struggling Rust-Belt economy, the fading prominence of the manufacturing sector, and Cleveland's challenges in attracting a meaningful replacement.

56. According to the U.S. Conference of Mayors, Cleveland's Gross Metropolitan Product grew at the annual rate of 4.2 percent over the ten-year period ending in 2003. This placed the City ***243rd*** among major metropolitan economies in the United States.

57. Other studies confirmed Cleveland's serious economic problems during the subprime lending craze.

According to the Brookings Institution, the City ranked at or near the bottom when it came to its residents' average household income:

	2000			2005			2006		
	NO	PCT	RANK	NO	PCT	RANK	NO.	PCT	RANK
LOW (>$20,000)	75,518	39.6	3	74,033	41.6	2	65,067	38.6	2
MODERATE ($20,000-$34,999)	44,999	23.6	7	41,772	23.5	4	39,547	23.5	6
MIDDLE ($35,000-$59,999) ($35,000-$49,999) (2000)	28,814	15.1	78	33,034	18.6	98	28,814	21.6	78
UP. MIDDLE ($60,000-$99,999) ($50,000-$74,999) (2000)	25,592	13.4	95	21,625	12.2	96	19,342	11.5	99
HIGH ($100,000+) ($75,000+) (2000)	15,802	8.3	100	7,353	4.1	98	8,103	4.8	100

Gross numbers refer to households. Rankings place Cleveland among 100 largest cities in United States.

	2000		2005		2006	
	AMOUNT	RANK	AMOUNT	RANK	AMOUNT	RANK
MEDIAN INCOME (BY HOUSEHOLD)	$26,735	98	$24,105	100	$26,535	100
POVERTY RATE	26.3%	5	32.4%	1	27.0%	6

Rankings place Cleveland among 100 largest cities in United States.

58. Not surprisingly, given these considerations, foreclosure had already was becoming a serious problem in Cleveland early in this decade, even while residential real estate remained the hottest of commodities elsewhere in the United States.

59. Securitizers could hardly claim ignorance of these economic realities, which should have eliminated Cleveland as a market for widespread subprime lending. In fact, these Defendants were setting the stage for financial catastrophe by:

(1) making credit available to borrowers at higher-than-average interest rates, notwithstanding their worse-than-average credit histories;

(2) abandoning underwriting standards that protected both borrowers and lenders;

(3) using "teaser" rates and similar tactics to hide the true burden of borrowing;

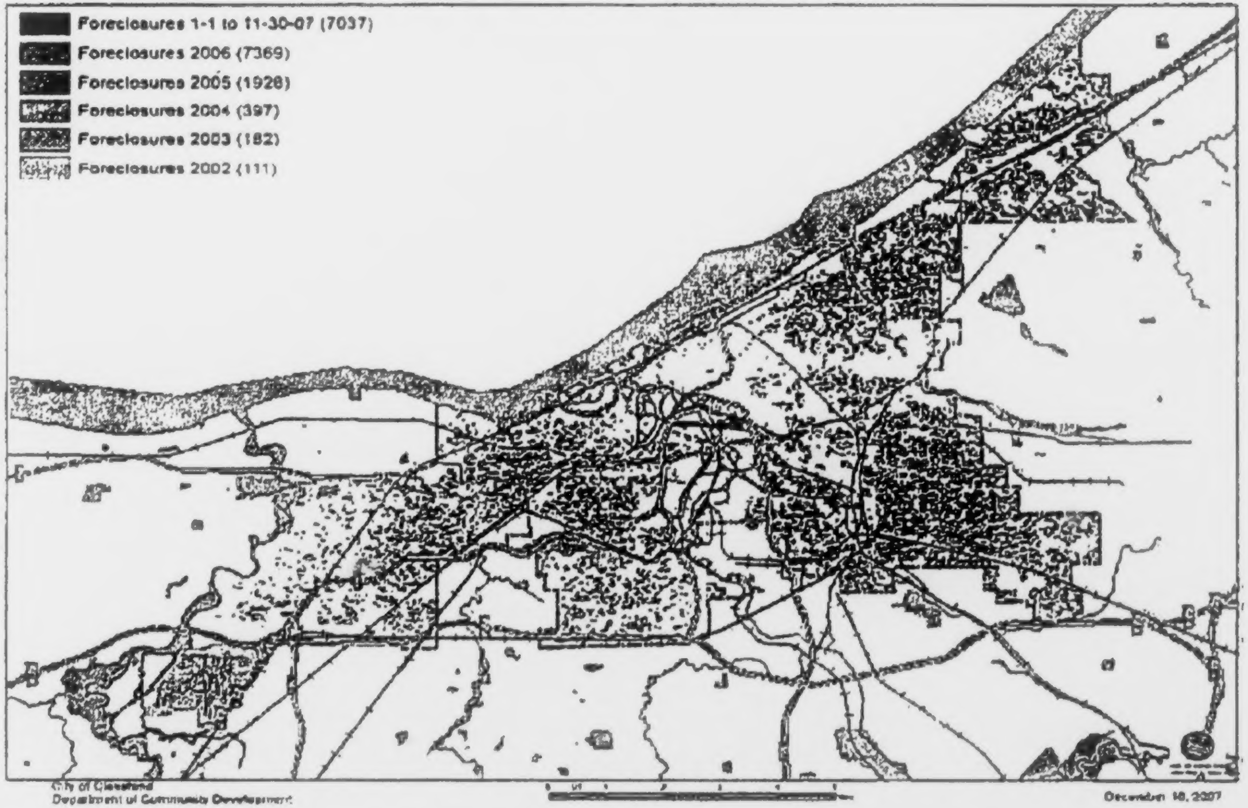
(4) doing so under economic conditions that afforded borrowers little economic opportunity or mobility; and

(5) doing so in a real estate market that remained essentially frozen, even while boom times continued elsewhere.

60. These circumstances predetermined the harsh results of the subprime blitz directed at Cleveland. As indicated above, foreclosures in the City have increased exponentially since 2002.

61. An average of 20 Cleveland homeowners faced the grim reality of foreclosure each day during 2007. The epidemic affected almost all parts of the City:

City of Cleveland - Foreclosures


■ Foreclosures 1-1 to 11-30-07 (7037)
▨ Foreclosures 2006 (7369)
▨ Foreclosures 2005 (1928)
▨ Foreclosures 2004 (397)
▨ Foreclosures 2003 (182)
▨ Foreclosures 2002 (111)
0
1/2
1
2
3
4
5

City of Cleveland
Department of Community Development

December 18, 2007

62. Cleveland currently has approximately 22,000 properties left vacant as a result of foreclosure.

VII. **Damages Suffered by the City of Cleveland**

63. The City of Cleveland was an innocent bystander with respect to the influx of subprime money within its borders. It received none of the financial gain the Defendants extracted in promoting this type of financing.

64. Having had absolutely nothing to gain from the subprime industry, Cleveland now must deal with the devastation it has inflicted upon the City. Each and every foreclosure creates certain tangible costs for Cleveland, particularly if the property remains vacant for any extended period of time. As indicated above, these may include increased expenditure for fire and police protection, or the cost of demolition. In any individual case, the City's expenses may range well into five figures.

65. The subprime mortgage crisis has also ravaged Cleveland's property-tax revenues, the amount of which turns upon the appraised value of real estate in the City.

66. Foreclosures decrease the value not only of the affected homes, but surrounding properties as well. The magnitude of this spillover effect is tremendous – a study recently released by the Center for Responsible Lending determined that homes in Cuyahoga County collectively depreciated more than ***$462 MILLION*** due to their proximity to foreclosed property. Cleveland residents have already begun challenging

assessments on their homes in light of the blight inflicted by the foreclosure crisis.

67. The municipal cost of foreclosure has long been known. For instance, in June 2000, the United States Treasury Department and the Department of Housing and Urban Development issued a joint report on predatory lending. The report addresses the elevated rate of subprime foreclosures, and their role in hastening the deterioration of various urban communities. Economists and academicians had also extensively addressed this same topic. Just as the Defendants could have and should have foreseen the mass foreclosures they were causing in Cleveland, they could have and should have anticipated the damages the City would suffer as a result of their actions

COUNT ONE
[Public Nuisance]

68. The City incorporates by reference the allegations contained in all preceding paragraphs of this Complaint.

69. The Defendants are liable to the City of Cleveland for public nuisance for their respective roles in proliferating toxic subprime mortgages within its borders, under circumstances that made the resulting spike in foreclosures a foreseeable and inevitable result.

70. The City suffered damage as the direct and proximate result of the Defendants' unlawful conduct, including (a) the cost of monitoring, maintaining, and demolishing foreclosed properties, and (b) decreased

tax revenues resulting from the depreciated value of the affected homes and all surrounding real estate.

71. The Defendants face liability for both punitive and compensatory damages under this claim for public nuisance, given the actual malice they manifested in committing the tort.

WHEREFORE, the City of Cleveland respectfully requests the following relief:

- An award of compensatory and punitive damages, in amounts the City will quantify;
- an award of costs and attorneys fees;
- interest; and
- any other relief that the Court deems just and equitable.

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JURY DEMAND

Pursuant to Fed. Civ. R. 38, the City of Cleveland respectfully demands trial by jury on all eligible causes of actions and issues.

/s/ – Joshua R. Cohen
Joshua R. Cohen

[*Certificate of Service Omitted in Printing of this Appendix*]

* * *